NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

CIS Congressional Information Service Washington D C

S. HRG. 101-447

ROUNDTABLE HEARING ON HOMEOWNERSHIP AFFORDABILITY

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

S. 566

TO AUTHORIZE A NEW CORPORATION TO SUPPORT STATE AND LOCAL STRATEGIES FOR ACHIEVING MORE AFFORDABLE HOUSING; TO INCREASE HOMEOWNERSHIP; AND FOR OTHER PURPOSES

THE NATIONAL AFFORDABLE HOUSING ACT

JUNE 9, 1989

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

22-940 WASHINGTON : 1990

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S241-9

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

DONALD W. RIEGLE, JR., *Chairman*

ALAN CRANSTON, California	JAKE GARN, Utah
PAUL S. SARBANES, Maryland	JOHN HEINZ, Pennsylvania
CHRISTOPHER J. DODD, Connecticut	ALFONSE M. D'AMATO, New York
ALAN J. DIXON, Illinois	PHIL GRAMM, Texas
JIM SASSER, Tennessee	CHRISTOPHER S. BOND, Missouri
TERRY SANFORD, North Carolina	CONNIE MACK, Florida
RICHARD C. SHELBY, Alabama	WILLIAM V. ROTH, JR., Delaware
BOB GRAHAM, Florida	NANCY LANDON KASSEBAUM, Kansas
TIMOTHY E. WIRTH, Colorado	LARRY PRESSLER, South Dakota
JOHN F. KERRY, Massachusetts	
RICHARD H. BRYAN, Nevada	

KEVIN C. GOTTLIEB, *Staff Director*
LAMAR SMITH, *Republican Staff Director and Economist*

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

ALAN CRANSTON, California, *Chairman*

PAUL S. SARBANES, Maryland	ALFONSE M. D'AMATO, New York
CHRISTOPHER J. DODD, Connecticut	CONNIE MACK, Florida
JIM SASSER, Tennessee	NANCY LANDON KASSEBAUM, Kansas
JOHN F. KERRY, Massachusetts	LARRY PRESSLER, South Dakota
RICHARD H. BRYAN, Nevada	PHIL GRAMM, Texas

W. DONALD CAMPBELL, *Staff Director*

CONTENTS

FRIDAY, JUNE 9, 1989

Opening statements of:	Page
Senator Cranston	1
Senator Pressler	3
Senator D'Amato	6
Senator Sasser	9
Senator Kerry	10

WITNESSES

George Butts, chair, ACORN-Philadelphia, Philadelphia, PA	4
Shirley Wiseman, president, National Association of Homebuilders, Washington, DC	6
Prepared statement	51
Gail Cincotta, chairperson, National Peoples Action, Chicago, IL	7
Prepared statement	61
Willard Gourley, Jr., president, Mortgage Bankers Association, Washington, DC	8
Prepared statement	116
William H. Lacy, president, Mortgage Insurance Companies of America, Washington, DC	10
Prepared statement	129
Ira Gribin, president, National Association of Realtors, Washington, DC	13
Prepared statement	154
John Papandrea, commissioner, Department of Housing, Hartford, CT	14
Karney Hodge, director, California Housing Finance Agency, Sacramento, CA	15
Prepared statement	174
Joseph J. Morris, chairman, Champion Home Builders Co., Dryden, MI	16
Robert Edelstein, cochair, Center for Real Estate and Urban Economics, University of California at Berkeley, Berkeley, CA	18
Prepared statement	183
Barbara Bannon-Harwood, president, BBH Enterprises, Dallas, TX	21
Prepared statement	191
David Perel, manager, Municipal Finance Department, Los Angeles, CA	22
Prepared statement	210
Robert B. O'Brien, Jr., chairman, Carteret Savings Bank, Newark, NJ	23
Prepared statement	213
Dean Weatherly, Pinal County Supervisor, Casa Grande, AZ	27
Prepared statement	219
David W. Balcer, senior vice president, First Financial Bank, Milwaukee, WI	27
Prepared statement	229

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

National Congress for Community Economic Development, statement on the homeownership section of S. 565	249
Ads from the Washington Post, dated February 13, 1989 and March 26, 1989	252

ROUNDTABLE HEARING ON HOMEOWNERSHIP AFFORDABILITY

FRIDAY, JUNE 9, 1989

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met at 10 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Alan Cranston (chairman of the subcommittee) presiding.

Present: Senators Cranston, Pressler, D'Amato, Kerry, and Sasser.

OPENING STATEMENT OF SENATOR CRANSTON

Senator CRANSTON. This hearing roundtable will please come to order.

I appreciate the presence of all of you, those in the panel and those who are here for other purposes.

This is the fifth in the subcommittee's series of hearings on the National Affordable Housing Act.

The bill is receiving strong bipartisan support. We now have 40 cosponsors, including leading Senators on both sides of the aisle and a solid majority of the Senate Banking Committee.

I expect the Senate Banking Committee will be able to act on the bill before the August recess and that the bill can be considered on the Senate floor in the fall. We would expect to complete action with the House next year.

Your suggestions today will be directly useful as we make final refinements in the legislation that goes to committee for markup.

Our bill culminates a remarkable 2-year review of the Nation's emerging housing crisis. An enormous number of sound ideas have been submitted by housing leaders from across the country. We have tried to incorporate the most workable of those ideas into a balanced, comprehensive piece of housing legislation.

I believe the National Affordable Housing Act provides an excellent foundation for an effective, new national housing policy. It will help homeless Americans obtain decent, safe, and affordable housing. It will build strong partnerships among States, localities, nonprofit organizations, and private industry to provide long-term affordable housing, and it will help first-time home buyers who are struggling to purchase a home.

This morning we will examine provisions of the bill that are designed to expand homeownership. The increasing pressure on

homeownership is deeply troubling. The Nation's homeownership rates, after having risen steadily since World War II, have turned down since 1980. On the west coast, in my own part of the country, homeownership rates among young families have fallen by about 20 percent since 1980.

Far too many Americans who are struggling to buy their own home are finding that their dream of homeownership is drifting out of reach. Young and growing families are especially hard hit by the difficulty of making a downpayment. A new housing policy must provide assistance on that front.

One key provision of the bill would allow FHA to insure mortgages up to 95 percent of the median home sales price in each State. Similar ceilings would be provided for multi-State metropolitan areas, and the Secretary of HUD could designate substate areas where that is necessary to provide moderate and middle income families with fair access to FHA insurance.

This provision would be of particular benefit to first-time home buyers because the current nationwide cap makes low downpayment FHA insurance unavailable for modest starter homes in large areas of the country.

Another important provision would allow FHA to insure up to 97 percent on the first $50,000 of home's value. Presently, FHA can only insure up to 97 percent of the first $25,000 of value. The cap has not been adjusted during the last 11 years, while housing costs have greatly increased. So the bill proposes a long overdue adjustment.

A third provision would provide special assistance to first-time home buyers. FHA would be allowed to insure up to 97 percent of the value of a home if the potential owner is a first-time home buyer and has completed an approved homeownership counseling program. This change in law would help young families who have clearly demonstrated a commitment to homeownership and a capacity to meet their monthly mortgage payments.

Still another provision of the bill would permit FHA to insure adjustable rate mortgages that conform to standards generally adopted in the market.

Finally, a provision of the bill that has been referred to the Finance Committee would allow first-time home buyers to use a portion of their IRA and 401(k) retirement accounts for a downpayment on a home. Currently, IRA and 401(k) participants can invest their retirement account in someone else's home but not in their own. Our bill would expand the eligible investments for retirement accounts to include the taxpayer's own home. That is a sensible change in law because, after all, Americans have usually found that their own homes are their best investment for retirement.

The National Affordable Housing Act will receive intense scrutiny as it moves through Congress. Each of you at the table this morning have had a significant impact on the act through the extremely helpful comments, criticisms, and suggestions that you have made throughout the early stages of the bill's development. Now, as the Senate prepares to act on the legislation, your candid assessment of these provisions as they now stand and your suggestions on how we may improve them are more important than ever.

I ask each of you to give us your best counsel so that we can create the first-rate piece of housing legislation that the country needs and the country deserves.

We are holding this morning's hearing in the form of a roundtable discussion. It is somewhat nontraditional for congressional hearings, but we have been experimenting with this. We find that it allows our witnesses and members of the committee to explore the major issues much more fully and usefully. The main objective is to get a dialog going and to get contrary views expressed and comments and criticisms on what members say, which is the best way for us to refine the issues.

I encourage you to comment on areas where you have disagreements as well as agreements. I know some of you may be startled that so many members are on the panel, but we had a similar number yesterday or the day before and had a very good dialogue the way we operated. It does require brevity so that there is a full opportunity for everyone to participate. I will do my best to ensure that everyone does have that opportunity.

I am very grateful to you for your presence, and we will now start the discussion.

Larry, do you have any comments?

OPENING REMARKS OF SENATOR PRESSLER

Senator PRESSLER. Yes, Mr. Chairman.

I might say that I am required for a quorum this morning in another committee. They need a warm, living, breathing Senator, not necessarily a thinking one, but one who will make a quorum. I hope to come back. I think this roundtable is a good innovation.

I am very interested in how this bill will affect smaller towns, rural areas, lesser populated areas. When we think of housing problems, we usually think of big cities. My staff is working with Senator D'Amato's staff and others to be sure that States such as mine, South Dakota, and indeed upstate New York, I suppose, and parts of California that are not in great population centers are treated fairly and are held harmless.

I am also very interested in the IRA and 401(1)(k) Keogh type proposals as part of this, as a way to expand opportunities for people to own their homes. I share in the chairman's statements that ownership of a home is something that is the dream of every American, and we must keep that dream alive.

So, Mr. Chairman, I commend you for this innovative way of holding these hearings, and I will be in and out this morning.

Senator CRANSTON. Thank you very much, Larry.

You all have the discussion guide, I believe, before you. Let's start with the top of that.

Before we discuss specific legislative features of the bill or ideas for other ways to approach them, I would like the benefits of your insights into the problems facing families struggling to achieve homeownership.

We have all heard disturbing statistics of falling homeownership rates and other measurements showing a growing problem. Each of you have extensive experience related to the problems of home

buyers. So I would like you to speak from your own personal and professional experience as much as you can.

So the questions that I hope we can cover briefly are:

To what extent is there a severe problem of homeownership affordability in our country?

How has it been changing in recent years?

How is it likely to change in the near and foreseeable future if there is not a change in public policy?

Where is the problem most intense?

To what extent is this a problem throughout the country, or is it a problem in limited areas around the country?

What makes up the problem of first-time home buyers?

To what extent is it a problem of downpayment, monthly costs, other factors?

What are the major contributing factors?

Who is most affected?

How is the problem having a different effect on different age or income groups?

And how do problems with homeownership affordability contribute to other problems in our society, such as transportation, family stress, drugs, crime, upward pressure on rental rates, and so on?

Can somebody give me the answer to all those questions? [Laughter.]

Who would like to lead off?

Yes.

GEORGE BUTTS

Mr. BUTTS. My name is George Butts. I am president of Philadelphia, PA's ACORN Housing Corp.

First, I am glad to be here to offer our views on homeownership and that we believe that the National Affordable Housing Act is significant and creates a step forward in our desperately needed national housing legislation.

We believe, though, that there are some problems that we have encountered in the 4 years or so that we have been involved in providing low- and moderate-income housing in Philadelphia.

Briefly, let me explain what it is we have tried to do. We started a few years ago. Philadelphia has a large abandonment rate, like 23,000 abandoned houses in Philadelphia, and ACORN, which is a grass roots organization whose membership comes from the people who live in those areas, tried—decided to do something about that problem, and we petitioned the city to turn some of those abandoned properties into home income—homes for people, and after a lot of ranting and raving and yelling and screaming and protesting and all that kind of stuff the city decided, yes, we could have some housing.

Then we found that once we got the property we had no way of getting it fixed up. So our bank—the ACORN National Bank Initiative came out of those kind of problems, since we figured that the place to go get the money would be the place where they had the money, which is the bank.

So we approached a lot of banks, and we have done some amazing things in Philadelphia in terms of getting the banks to under-

stand what the needs of low- and moderate-income housing is and to make homeownership accessible, and I think that more than anything else that is what the problem is, for us at least, is changing people's attitudes about low- and moderate-income people and whether or not we had—you know, homeownership should be a viable option for us.

A lot of times people don't even assume that a low income-person can afford a house. In a lot of cases they can. It is just a question of putting supports in place and creating opportunities to build up the whole menage and make sure that people can afford the mortgages and make sure they understand what homeownership is about, and at the Housing Corporation that is what we do.

We have a counseling program. We use a large equity component to help bring down the labor costs. We do all those kind of things to try to make the bill lower so everybody can afford homeownership, and with the banking agreement in place, that is what makes the mortgage a little more affordable because we have relaxed underwriting standards. We do things like allow food stamps to be used as part of their income, using a longer income stream to determine whether or not a person can qualify for a home.

What we have really done was try to convince the bank that you have to deal with poor folks on a level that they can be dealt with on and look at it as a different kind of market, but a market that is there to be served, and those kind of things are happening, and now there is almost $60 million exploded in our community in the past couple of years from these agreements that wasn't there before.

But we still have some problems with FHA in terms of being able to get FHA mortgages. We haven't been able to because in some cases they just say they just don't write mortgages in our area, which sounds suspiciously like redlining to me.

But those kind of things are happening, and I think what the Government really has to do is just look at things differently and try to do everything that can be done to change the way the systems work.

I think I am the only poor person here. A year ago this time I had no home. I didn't have a house. I had gotten burned out Christmas Eve the year before. We took an abandoned house and made it into a home.

So I know the program works because we have done it. I know that we have helped a lot of people that can get housing, but it has been such an uphill fight for us, robbing Peter to pay Paul a lot of times. A lot of times HUD forces us to buy the abandoned properties that we are trying to use to turn over to people.

So that adds to our costs, and what we would really like HUD to do would be to give us those houses at a nominal sum, like $100 or something, because really what we are doing essentially is we borrow the money from the city to acquire these homes and then have to figure out financing for the homes and pay for the acquisition costs, and we get the acquisitions from the city, who gets their money from CBDG funds, which is sort of like robbing Peter to pay Peter, much less Paul.

So there is a lot of stuff that can happen, but I think everybody that is looking at this has to look at it from the point of view that

it is something that can work and we just have to figure out what we need to make it work and not approach it from the attitude that is, you know, something that we have to shuffle off into a corner and that we—that low- and moderate-income people deserve housing just like everybody else. We just have to figure out a way to do it.

I will jump in later.

Senator CRANSTON. Thank you very much.

Senator D'AMATO. Mr. Chairman.

Senator CRANSTON. My Republican partner in the Senate, Al D'Amato, is now with us.

Al, do you have any remarks to make at the outset?

OPENING REMARKS OF SENATOR D'AMATO

Senator D'AMATO. Well, Mr. Chairman, none other than to congratulate you for your steadfastness in this enterprise and also to pay accolades as it relates to the format. I don't know how many of the people who are here today have ever participated in the general hearing where three or four people will testify, they get an opportunity to read a prepared statement in a matter of 5 to 7 minutes, and that generally gives us an opportunity to ask maybe one or two questions at most, and it is often rather fragmented.

The manner in which the Senator is conducting these hearings provide an opportunity for the input dovetailing one on the other so we can get follow some semblance and where people will have the opportunity to add and make contributions.

To date we have had—I think that we have—I know yesterday there were some very, very positive suggestions that came from the witnesses, and I look forward to listening to the people on the frontline as it relates to the crisis that we face in housing, and particularly as it relates to the dimensions of the problem for the poorest of the poor in the area of policy.

I commend our distinguished chairman.

Senator CRANSTON. Yes?

Thank you, Al, very much.

Yes?

SHIRLEY WISEMAN

Ms. WISEMAN. Thank you, Mr. Chairman, Senator D'Amato.

I am Shirley McBay Wiseman. I am president of the National Association of Home Builders, and we are here today in full support of this legislation.

I would like to just comment about your question, Mr. Chairman, about is there an affordability crisis.

I can assure you that when the median price of a home in Pine Bluff, AR, is $133,000 there is an affordability crises. It is not just on the east coast and the west coast. There is a crises across this nation.

And how the bill addresses raising the limits—if I had to single out one thing, I think we need to be for housing for everyone from the east coast to the west coast and not just middle America, and we can see by the $133,000 median price in Arkansas, which is

where I originally came from, it is not just a coastal problem. It is across the board.

The downpayment issue—that is certainly a crises that you have addressed—is of major significance. The Harvard joint center study that will be released very shortly shows that in 1986, Eighty-one percent of the prime home buying age could not afford the downpayment. 81 percent. That is a significant number.

So, yes, there is an affordability crisis, and I commend you for addressing these problems.

Senator CRANSTON. Thank you for shedding that light.

Yes?

GAIL CINCOTTA

Ms. CINCOTTA. I would like to pass this around. We did some research on where downpayment is the problem, and what we looked at is that the average downpayment of people in three cities is already 22, 16, or 10 percent. If you follow down the sheet, New York, Chicago, Memphis, respectively, it is the monthly payments that are the killers, and by lowering downpayments, say in New York, where your median buyer income is $52,000 already and the average monthly payment is $1,310, and as a percent of income that's 47 percent, you are not helping that person by lowering the downpayment. They already are putting in more than the existing minimum 5 percent downpayment.

The problem is the cost of the house. It is a lack of affordable housing, both rental and new construction, that is the problem.

We also looked at who is being hurt by this, and where homeownership has gone down as measured by the income level of people being able to purchase a first home. Where homeownership rates went down is people making under $40,000 in income. It went down from 59 percent to 40 percent from 1985 to 1988. Homeownership rates went up for families making $40,000 to $60,000 in income, and homeownership went up for people making over $60,000 in income, also.

This information came from the Chicago Title and Trust's 13th annual national survey of home buyers. We didn't make up these figures. What I feel is being skewed in these hearings is the claim that the downpayment is the problem, and that it is the folks that are making big money that can't afford to buy a home.

But if these figures are true and you have no reason to say they are not, downpayment is not the problem. Making FHA downpayments 3 percent won't solve the problem. The problem is the amount of affordable housing that has to be reclaimed, rehabbed, added to, so that your housing stock is increased. If you come up with a lower dowpayment in FHA you are going to make monthly housing costs worse. You are going to drive the cost of housing higher because what is going to be built is new and bigger housing.

I don't know that you should let people use their Keogh's, IRA's, et cetera, for a downpayment. I don't care if they use them if they pay taxes—if they are taxed so that they dont't have a competitive edge with the majority of the people who don't have IRA's, Keogh's, or vested pension funds. So if they pay their tax on that money so it is considered just savings like everybody else's, I

wouldn't have a problem. Except that if the people end up losing their homes under a lower downpayment and higher cost, people will not only lose their homes but they are going to lose their investment in a retirement. So they are going to get a double whammy, and I don't know if the Congress of the United States wants to be responsible for that, and that is a scare.

I think there is other ways of helping. We have come up with the HOME program with MICA as an alternative way to encourage savings, to help people have more equity and money that can be used as a downpayment and matched. We feel that the HOME program is fiscally responsible.

I don't know at what point in this today you want to get into that, but our sense is that it is the lower income people who aren't able to buy homes and the problem isn't the downpayment. It is the cost of the house, which then is the monthly payment.

Senator CRANSTON. We will get into those latter details later.

May I solicit a contrary view on the two points that she made? Yes.

WILLARD GOURLEY, JR.

Mr. GOURLEY. I am Willard Gourley. I am president of Mortgage Bankers Association, and I am from Charlotte, NC.

And one thing that is clear as it relates to downpayments is that those persons who have the hardest time getting the downpayment are the ones with a lower income and most of the marketplace. If you look at the problems that we have, a significant part of the affordability crisis is the ability to accumulate enough money for a downpayment, the downpayment that goes with both the equity in the house or the eventual payment on that. This includes as well the closing costs related thereto, the cash requirements up front and having sufficient residual left over cash to make it practical for them to buy.

And certainly the affordability crisis centers on the age group of 25 to 34 where the homeownership rate has dropped 15 percent over the last—in this decade, in the 1980's. The problems there are more downpayment—or maybe not more, but certainly equal, and probably more downpayment than the other pieces of the pie. They have got to get that money together before they have a shot to even to consider how much house they can afford, I mean from the standpoint of monthly payments.

So we are very strong supporters of the lowering of the downpayment. That would bring a larger group of people into the marketplace.

Senator SASSER. Mr. Chairman.

Senator CRANSTON. On the points she made about monthly payments becoming so heavy, it is a pretty horrendous rise in 1976 from $313 a month to 1988, $929 a month.

How can people handle that?

Mr. GOURLEY. Well, that is part of the whole process, obviously, where higher interest rates have had something to do with that as well as the higher cost of housing. Both of those have tacked into the higher cost. And so we need to do something about both of those. We continue to have high interest rates because of the na-

tional—the big budget deficit or whatever causes high interest rates. We need lower interest rates to help the affordability crisis, too. But downpayment is a critical part of it.

Senator CRANSTON. I welcome Senator Sasser, who has some remarks, I believe, to make at the outset.

Senator SASSER. Mr. Chairman, I will just put my remarks in the record.

Thank you.

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Thank you, Mr. Chairman, for calling this hearing on the pressing issue of declining homeownership in America. We've all heard about the decline in honeownership that's occurred since 1980. Indeed, if the pre-1980 trend had continued well over 2½ million more families would own homes today.

We have a nation increasingly of renters. A nation of young people that have a very difficult time achieving what came relatively easily to their parents—buying a home. This difficulty will mean, if not corrected, that today's parents will have less stable environments in which to raise children. They may miss their only real shot at amassing any kind of wealth.

Mr. Chairman, we're here today to examine your far reaching and thoughtful legislation. In particular, we'll be looking at certain refinements of the programs of the Federal Housing Administration—provisions that are derived from legislation that I introduced last year.

Mr. Chairman, there are some competitive concerns about expanding the FHA—about a modest lowering of its downpayment requirements and a raising of its mortgage limits. However, in view of today's massive housing crisis, I think we need to utilize proven, effective, money-making programs, like FHA, to the maximum degree possible.

The FHA has provided the opportunity of homeownership to over 15 million American families during the half century of its existence—at the same time it has made money for the Federal Government. Even today, 72 percent of its customers are first-time homebuyers.

And importantly, it continues to do the best job of providing homeownership to low- and middle-income Americans. Indeed, in 1987, the average income of an FHA buyer was 34 percent lower than that of buyers who received private mortgage insurance.

And as far as FHA's financial viability goes I'll defer to the GAO, which found in its recent audit that FHA had reserves of $1.2 billion, after setting aside $2 billion for all projected losses. In fact, the GAO said it would take a national drop in housing prices of 46 percent over 5 years to wipe out FHA's equity. Peat Marwick & Mitchell said FHA would have a "double A" rating if it were a private firm.

So, Mr. Chairman, I do propose that we make a moderate reduction in the FHA downpayment to help put homeownership within closer reach of young American families. And I propose that we permit it to raise its mortgage limits so that it can serve all areas

equally and disperse its risk geographically as any prudent insurance company should.

Mr. Chairman, as you know, these proposals for FHA were contained in the recommendations of the Rouse/Maxwell National Housing Policy Task Force. That esteemed group spent months examining the problem and hearing from every interest group. They strongly made these recommendations for FHA. I think they and the other provisions of your legislation deserve our strong consideration. Thank you.

Senator KERRY. Mr. Chairman.

Senator CRANSTON. Is there a comment relevant to the discussion we have been having thus far?

Senator KERRY. Mr. Chairman.

Senator CRANSTON. Senator Kerry.

OPENING STATEMENT OF SENATOR KERRY

Senator KERRY. Mr. Chairman, I just wanted to ask while you are on the subject of this question of downpayment, et cetera. As you know, I am a principal cosponsor of the National Affordable Housing Act, but I have an amendment that will be discussed at some point.

That is a first-time home buyer plan based on—modeled on what has been attempted in Michigan and which is an actuarial plan contract where people would actually purchase a downpayment contract with participating banks with a tax-free interest package, and that downpayment will be available to them at the end of the period of their contract and they can either take a mortgage with that bank or another bank when that time comes.

But if there is a differential at the time that the contract is due on the downpayment on the house, if there is a differential between the amount that contract provided and the cost of the house because of the increase due to depreciation, that will be covered by the pool of participants within this process and the Secretary of HUD can then change the prices as you go along to meet the demand, to make up whatever gap may or may not exist, and in some markets you may have a depreciation conceivably, as we are seeing today.

That is one way of increasing savings because of the incentive to both have a home as well as have the tax-free benefit of the interest, minimal cost in terms of lost revenues, and the second, the twofer in it is you have a first-time home buyer incentive, and it goes only to the mean average cost of housing within the region and only for those people who have never purchased a first-time home or not purchased within 3 years.

So I don't know how many of you have had a chance to review this concept or are familiar with the Michigan concept, but if in this context you have a chance to comment on it, I would certainly appreciate hearing about any of your thoughts.

WILLIAM H. LACY

Mr. LACY. Mr. Chairman, I would like to comment on that.

Our industry is the Mortgage Insurance Companies of America, and we have helped some 8 million people get homes with low

downpayments, and we understand the affordability problem from two dimensions—one, a downpayment, and two, the ability to make that monthly payment after the people get into the home. We understand clearly what Mr. Butts and Ms. Cincotta have said here this morning, which is critically important because these are the people who we need to help in terms of their constituents.

And even Gale's sheet here, if you look carefully, you will see that the accumulation of the downpayment for both the high-income and the low-income group took the same period of time, 2.4 years, and I think that the issue of accumulating the downpayment is critically important. Incentives to do that, ways of giving people the inducement to do that, will help us a great deal, and that drives to the point of targeting to income and to those people who need the help.

The great concern that I have and we have about this legislation as professionals in this business is that expanding FHA on sales price is not going to help the people we are trying to help. In fact, it will actually hurt them. The issue is one of looking at incomes, helping people accumulate that downpayment, to accelerate that process. We have found that the lower income people are the people who are suffering the most and need the most help, and by expanding FHA along the lines that the bill is going with increasing loan limits of 95 percent of the median sales price, we are actually going to hurt those people.

We are going to hurt those people, and that is something I would like to discuss in some detail because I think it is critical, both from a social responsibility and ultimately a fiscal responsibility, because it will drive more losses into the FHA program.

Senator CRANSTON. What do you recommend as the alternative?

Mr. LACY. Well, we have worked with Gale's group and others. We have worked with Mr. Butts, and we have housed a lot of people, and we are going to house a lot more, and the way we have done that is to deal with people, help people accumulate a downpayment. We have done counseling so people can understand what they can afford, and we have put them into shelter and we have gotten them into housing that is very acceptable to them. It is not high cost housing.

The high cost housing has to go to the wealthier people because they have the income to afford the monthly payment.

There is adequate housing that we need to focus on with these Government programs like FHA, and the private sector has done a lot with Mr. Butts and with Ms. Cincotta to do that very thing.

So we have proposed a concept that we have submitted. It is called the "homeownership made easier" concept, similar to things that have already been described here along these lines, and, Gale, perhaps you want to comment.

Senator CRANSTON. Gale, let me ask you one question on the 2.4 years that it took to accumulate the downpayment. That is for people that did manage to buy, I presume.

Ms. CINCOTTA. Right.

Senator CRANSTON. But it doesn't cover those who were squeezed out totally?

Ms. CINCOTTA. No, but it didn't change from 1976 to 1988. It didn't take longer in 1988. I think people are squeezed out because

of the monthly payments. With Mr. Lacy, we have developed a program to help people accumulate a downpayment that are squeezed out because of the monthly payments. You have got to lower the cost of housing. You have got to build more housing so that you have more available.

And I would like for the record to start off—I am like Mr. Butts. I lived in a neighborhood that was devastated when FHA was used to redline. FHA came in the cities in the 1960's, and we spent years and years and years trying to remake our communities and get the banks and the private sector, savings and loans into our communities because they weren't 100 percent guaranteed, which FHA does.

And when I read in the legislation of 3 percent mortgages when this past year FHA owned over 90,000 defaulted homes, a lot of them still in my neighborhood, it is the scariest thing. That is going to drive the cost of the housing even higher. We are going to be devastated, not only in the cities.

But what you have now—FHA was originally set up as a new construction program. It redlined the inner cities with older homes. In the 1960's it came in and now it is for both, you know, new and old homes. In the 1960's and 1970's it devastated the city. Now, 1989, you have the cities with older construction and you have the inner ring suburbs.

So when you change FHA, liberalize it even more, you are going to expand what happened in the cities into the inner ring suburbs, the older suburbs, because you are talking about going whole communities at 3 percent or less down, older homes that have things go wrong with them, not new homes.

New homes, you have a chance. Everything is brand new, everything is guaranteed or has a warranty for a while. But with older homes you don't have that, and if one out of every six go, it is devastation.

And then if you have let them use their IRA's and Keogh's, they have lost their houses, we lose the community, they lose their pension.

But let me just read in some foreclosure rates.

By the end of 1987, about one in six FHA loans made in 1981 had resulted in default. Eighteen percent of home buyers making 5 percent downpayments in 1981 lost their homes. Twenty-seven percent of buyers making 3 percent downpayments lost their homes. Incredibly, 38 percent of buyers that utilized 100 percent financing in 1981 lost their homes.

This is from a GAO study.

Between 1980 and 1984, foreclosure rates on 5 percent downpayment FHA loans exceeded 10 percent. Foreclosure rates on loans with 3 percent downpayment exceeded 15 percent. Foreclosure rates on loans with downpayments under 3 percent were at or above 20 percent in each year, peaking at 40 percent foreclosure in 1982, when two in five households using Federal insurance to buy a home ended up being foreclosed on.

Think of what that does to our neighborhoods, what that does to the Federal deficit. What worries me is that you are looking for a quick fix that doesn't cost money up front. You can pass legislation. It will look like it is fixing something and it is not an expenditure and appropriation. But in the long run it is going to cost the

Federal Government and cost our neighborhoods an amount you never can make up.

Senator CRANSTON. Ira.

IRA GRIBIN

Mr. GRIBIN. Thank you, Senator Cranston. You see before you a very sad Laker fan. [Laughter.]

I would just like to address one point. It reminds me of the story of someone who was asked how they felt, and they said, well, my head is in the stove and my feet are in the refrigerator and on average I am comfortable.

Remarks are constantly made about high priced areas and high income areas. I am a working broker in the city of Los Angeles, and a house that you can buy there for $200,000 is not dissimilar from a house that my sister-in-law owns in Ponca City, OK, which is worth $20,000.

Now, the realization of that woman coming from Oklahoma City or Ponca City to Los Angeles and understanding that the same house she cannot sell for 3 years for $20,000 is selling for $200,000 rather quickly in Los Angeles seems to her almost impossible.

And the one thing I find in all these discussions is nobody seems to understand that there are different areas with different needs and that we need to deal with it, which I think your bill definitely addresses. There is simply no doubt about the fact that by reducing the downpayment you will end up increasing saving because there is no question about the fact that—every survey shows—homeownership and people who own homes save more than people who rent. That is a known fact.

So it seems to us that we ought to try and get as many people into homes as we possibly can. If you reduce the downpayment, as you have suggested and which we strongly support, you are going to get people into homes who can afford to buy them and who simply cannot afford the downpayment to get into that home.

It seems to me that is a very great step in the right direction. To assume that these buyers have high incomes—as you well know, Senator Cranston, coming from California—high income in California at $50,000 or $60,000 or $70,000 is not a high income when you are comparing it in the final analysis to an income in other parts of the country.

People in Washington, people in Massachusetts, people in the New England areas, people in New York, and people in California understand this, and somewhere along the line I wish we could get this premise across that reducing the downpayment will help people get into homes. While the point has been made there are going to be more foreclosures, it seems to me that if you continue to put money in and not raise the cap you are going to have more people losing their homes because you are into areas that at the present time are very difficult.

In other words, if I want to bet, I want to bet on an area that is growing, that is economically sound, such as the areas we are talking about, because the chances of those people continuing to make the payments because their income will grow is a heck of a lot greater than in some of the areas that have been talked about.

What have been focused on are the areas that are in trouble. What have been focused on are the areas that are having the foreclosures and the result of it.

It seems to me that that is a continuing situation. We are investing money today and not investing in the difficult areas where there are potential losses. It seems to me they are investing in areas that are growing. By reducing the downpayment and helping those people to get into those areas, it seems to me you are helping get winners, and in my mind there will be less foreclosures, not more foreclosures as a result of that kind of activity.

Thank you.

Senator CRANSTON. John.

JOHN PAPANDREA

Mr. PAPANDREA. Thank you, Senator. John Papandrea. I am the commissioner of the Department of Housing in Connecticut.

I think our Governor Bill O'Neill not long ago put things in perspective with respect to what has happened in Connecticut when he said that today compared to 10 years ago what used to be the cost of a downpayment is now the monthly payment and what used to be the cost of the house is now in reality the downpayment.

So we are a very highly impacted area, and I am proud to say that Connecticut and the Department of Housing since 1978 has had a downpayment assistance program, and our experience is contrary to what I have heard here this morning and what I know that the congressional office has just reported because we have made over 3,000 downpayment assistance loans and we have had a total—and all of these were really in the very early years of the program before we got into the counseling of the prospective buyers—but we had 10 foreclosures in all.

Most significantly, in our pilot program of downpayment assistance, what we experienced—and here we are talking, by the way, of 100 percent financing, where we pay the full 25 percent, which ties in with the 75 percent given by the Connecticut Housing Finance Authority, with whom we work very closely—so with 100 percent financing in place we have not had in over 200 of the pilot loans that were made, not one single case of foreclosure.

And I think that is very significant because it points out the very real need to tie in counseling and support services at the bottom.

The other thing I would like to say with the little time I am going to have is that in Connecticut our problem is——

Senator CRANSTON. Al would like to ask you a question at this point.

Mr. PAPANDREA. Certainly, Senator.

Senator D'AMATO. John, in your program of counseling and downpayment, do you also tie that into a mortgage revenue package; in other words, whereby you are using the tax-exempt interest to lower that financing cost by up to 2 points?

Mr. PAPANDREA. That is done through the 75 percent that is provided by the Connecticut Housing Finance Authority, correct.

Senator D'AMATO. I would like to make the point that one of the provisions of the bill—and of course to finance—is that the continuation of the tax-exempt financing, mortgage revenue bonds and

expanding that so that people outside of the income, I think, which is arbitrarily—set arbitrarily low—get that opportunity because you if are talking about a 2-percent reduction for your financing, you are talking hundreds of dollars a month. If you are talking about a $75,000 mortgage, why obviously you are talking about $1,500 a year, and so on. Take that figure and apply it.

So I think that is one of the things which Ms. Cincotta raises the question, how do you help also reduce those carrying charges, and I think it is absolutely essential that that part of the package be passed as well.

Mr. PAPANDREA. Well, not only is that——

Senator D'AMATO. You have utilized that?

Mr. PAPANDREA. Yes, we utilize that in the 75 percent, you know, regular mortgage component financed by our housing finance agency.

Senator D'AMATO. So your mortgage costs are less than New York's?

Mr. PAPANDREA. Correct, but our 25 percent downpayment assistance is on a sliding scale. Presently, we are charging 6 percent, but the pilot program, we have gone anywhere from zero interest to 4 percent, and we have had a marvelous experience with it.

The biggest problem that we have faced in Connecticut is the incredible escalation in the cost of land, and we are a very small, land poor State. The one area I would literally beg you to pay as much attention to as you can is what happens after we make people homeowners.

Let me just give you a very brief instance. Under one of our programs where we allowed tenants in public housing to buy their own unit, we had an instance not long ago where someone who 7 previously had bought for $33,000 the unit occupied by that family. Seven years later a request was on my desk as commissioner to release the restriction so that that same unit could be sold for $280,000.

I submit that that kind of social escalation in value is something that we need to address. We are not going to penalize people if we place reasonable and proper limitations on profit. There is more to the American dream and ideal of homeownership than simply the profit motivation, and I would urge you to encourage the use of land trust, land banking, and any of the recapture vehicles and the limited equity type of approaches that would make the American dream possible, not only for the first generation that we want to make homeowners, but to see that their children and grandchildren after them also have that same privilege.

Senator CRANSTON. Thank you.

Karney Hodge.

KARNEY HODGE

Mr. HODGE. Senator Cranston, let me just take a moment and compliment you and Senator D'Amato and the committee for taking the initiative and the leadership to craft a housing bill that will indeed establish a national housing policy.

The bill certainly preserves the programs that have been successful, and I specifically refer to the program that Senator D'Amato

referred to, the mortgage revenue bonds. They have been extremely successful.

State agencies throughout the country have used them extensively. They address all of the issues that so far have been discussed: affordability, downpayment, cost of house, adding to the stock. And accordingly, obviously, we are in strong support of keeping that program within the bill.

I think most importantly in all of this is that you have established housing as a major issue that is being addressed by the country throughout, which up to this point for a long period of time has not been the case. I do not think that you are going to be able to please everybody 100 percent, but certainly from the hearings that you have had in the field and discussion groups such as this, you obviously are ultimately going to come up with a consensus that is going to put us far ahead of where we were some time ago.

I must say, Senator D'Amato, that program in California in particular has been very, very successful. We have got some 25,000 loans out there in the field. Our average house sale in California, which is a high cost area, is some $85,000. I am sure the median today in California is somewhere between $130,000 and $150,000. It keeps rising very rapidly.

Also, this program is—there are a lot of participants. There are the realtors, the home builders, the mortgage bankers, and the myriad of other industries that go to work when houses are built. We are also doing resale, as well as new construction.

So by and large, if I said anything today, I would really very wholeheartedly encourage that program to become really a major part of this housing bill.

Mr. MORRIS. Mr. Chair.

Senator CRANSTON. Mr. Morris.

JOSEPH J. MORRIS

Mr. MORRIS. Thank you, sir. It is a privilege to be here and to have an opportunity to talk to this august group. I, too, add my words of congratulations to you two fine gentlemen and to the group that you have got working to develop a new national housing policy.

The first major thing that pops in my mind, and the thing that I have heard this morning and that I hear constantly, everybody is talking about is the extremely high cost of homes. And it is a fact. But the truth is that there is an industry that can produce housing for the low- and moderate-income families at a figure they can afford.

Mr. D'Amato and Mr. Cranston, we have more than 12 million people living in homes built in a factory. By and large, they enjoy it. If Confucius says that one picture is worth a thousand words, I would like to pass a picture around of a conventional home built in the great State of North Carolina.

Sir, our industry stands, and can really help this housing problem. But we are zoned out. In the great State of Michigan, our little industry will sell 11,000 homes this year. In the State of Illinois, with 2½ million people more, we will sell less than 3,000, simply from zoning and State and local regulatory barriers. We

have been discussing here the need to reduce downpayments and increase mortgage limits because of the high cost of housing. It is true. If you take a $100,000 home, with an average downpayment of 10 percent, you have got a $10,000 downpayment. If you reduce it to 3 percent, you save that gentleman $7,000.

Senator CRANSTON. What kind of zoning are you talking about, precisely?

Mr. MORRIS. Precisely, sir, manufactured homes are zoned out of almost every major city in the country. Some of the image problem we have brought on ourselves, but our industry today builds a good home. It builds a home that I am proud to live in. I have 3 sons; they live in them.

We build 1,600 square feet of home there, 1,600 square feet that will appreciate in value, put in the right location. The only point I wanted to make, it is the low- and moderate-income families that are getting bombasted. They are the ones that cannot move into homes, basically, today. And if you help them with your 3 percent, you have helped them $1,400 worth. The other guy, you helped $7,000. Is that really the target we want to hit?

I suggest to you that, if we look at it closely, there have got to be ways that we can help them, maybe with rental subsidies on the land. Every subsidy that we have had in housing financed by Government forces in the past in apartment dwellings, has subsidized the entire apartment. Why not subsidize the land, and let the people have the pride of ownership of their home, going on a subsidized piece of land?

It is an exciting, interesting, and innovative piece of legislation you have brought to the American people, and it has got great promise. But I submit to you, with 12 million Americans living in our product, we really can help you. We have got factories in California and in the great State of New York.

When we can build a house like that, 1,600 square feet, for less than $40,000—it is the only thing you did not attack here, is the total cost of the house, itself. Thank you for letting me speak.

Senator CRANSTON. Thank you.

Senator Sasser has a question.

I want to object to your saying "California," and "the great State of New York." [Laughter.]

Mr. MORRIS. Sales are better right now, sir, in New York. [Laughter.]

VOICE. He meant to say that in reverse, Senator.

Mr. MORRIS. Yes.

Senator SASSER. Thank you, Mr. Chairman.

I want to address a question to Mr. Papandrea, and I would like to get his comment here. We have a situation in Chattanooga, TN, where we have families paying $550 a month to live in public housing. They have been living there month after month, year after year, with no defaults.

Now, they would be homeowners, if it were not for the downpayment problem, I do believe. Now, the legislation that I have introduced requires counseling, if the buyer is to receive a very low downpayment mortgage. There is a demonstration program that would permit downpayments, the actual downpayments themselves, to be financed. It would be a program that these people

living in public housing, who have conscientiously paid that $550 per month over a period of years, could transition into a home of their own.

I want to ask you, Mr. Papandrea, is it your feeling that counseling would help avert defaults on these that we are talking about financing even the downpayment itself? What has been your experience, if any?

Mr. PAPANDREA. No question. There is a direct tie-in between the kind of support and counseling services that are made available, and the respect with which property is maintained and the fidelity to the payments.

I would say that, in Connecticut, we have had experience with taking people who have been model tenants in public housing and opening opportunities of homeownership for them. In Bridgeport, CT, Father Pannik Village is known to be one of the most difficult and one of the most congested densely populated problem public housing complexes, not only in Connecticut but in the region. We have had incredible success in taking people who have proved that they are capable of the kind of counseling and support that we make available, and putting them into—the best example I can give you is the Roberto Clemente Complex, which is not that far from Father Pannik Village itself, where they have enjoyed the benefit of homeownership under our CHFA program, with a full downpayment assistance loan from the State.

What is required is that there be a very careful selection process that is fair and open, but yet that makes people in public housing aware that there is hope if they are willing to work and be responsible.

We have had the same experience in Waterbury, CT, and in Hartford, CT, where we have tried to work from the ranks of those who have helped themselves in public housing, who have paid their rent, who have shown that they are involved and they are concerned with the conditions in public housing and that they are ready to receive the kind of help that we make available so that they can share in the dream of homeownership. And I applaud that.

Mr. HODGE. I am not so sure that, the counselor, you should not be perhaps the party extending the credit as well as the party that is buying. [Laughter.]

No, it was not funny. I mean, I think that is the major aspect of the problem, if credit is prudently extended. I think that you can come up with all kinds of foreclosure figures, and I can show you counter groups of people where the rate certainly is not that high, but the credit extended is done far more prudently, and relatively speaking the foreclosure rate is much less.

Senator CRANSTON. Mr. Edelstein.

ROBERT EDELSTEIN

Mr. EDELSTEIN. My name is Bob Edelstein. I am a professor of business administration in the real estate area at the University of California at Berkeley—from the great State of California.

Senator CRANSTON. Greater than New York. [Laughter.]

Mr. EDELSTEIN. I was born in the great State of New York—and I have not lost the accent, they tell me.

I think that I am hearing today from the other speakers a conglomeration of symptoms, causes, and potential solutions. I would like to step back and address what I think are the fundamental issues that are causing the problem, and then I think policy has to be drawn from looking at what the problems stem from, and then analyze what the trade-offs may be.

In that trade-off, you have to ask, who do we want to help, and how much are we willing to spend to do that? And, where is it coming from?

Let me talk about what the fundamental issues are that are causing the problems that are very real. The first one is, quite clearly, a demographic crunch. If you look at the post-war baby boom, its highest point in births-per-annum was 1957 through 1961, which averaged 4.3 million births. We are now at the 3 million-plus range.

Obviously, those 4.3 million births are the households of today. If you add 1960 plus 25 or 30 years, you see them coming into the market in largest numbers. That is increasing demand.

That is additionally complicated by the fact that there are regional differences. Regional growth on the coasts during most of the 1980's has been substantially different than other parts of the country.

So if you have a large number of people entering the household-starting age, the household-formation age, and you have regional growth areas—such as the northeast corridor and the west coast where the economies have been booming, and there has been net migration, certainly to the west coast if not to the east coast. You have this overall demographic crunch. That is the demand side.

On the supply side, you have an overlay of a set of movements relating to environmental concerns, land use controls, growth controls. Those tend to reduce supply.

So you have growing demands—this is "Economics 1"—you have supply being constrained in certain areas, you are going to get price effects. Now, this is exacerbated even more by changes in the tax system. The tax system reduced marginal tax brackets, increased standard deductions. This makes it less attractive to be a homeowner.

If you now add on that what we are going through now, a major recasting—and I use that word gently; and to borrow from Mr. Hodge's comments, the leading oxymoron of today is "prudent lender." [Laughter.]

Mr. EDELSTEIN. But the debacle that is about to happen in the financing system for housing is going to make it even worse. In other words, we have not seen the worst of the housing crunch quite yet.

The underlying, fundamental problem is housing prices and relationship to household income. That is something that is not easily addressed and totally addressed just by housing policy as it is being talked about here. But I think you are on the right path, and I would not discourage you in any way, because you are opening the questions that I think have to be addressed.

Default issues—in Connecticut where housing prices were booming, defaults do not occur. You can always sell your house if a home owner gets into financial trouble. That is not where you see trouble. It is in Houston where there is no easy solution because the bottom has fallen out of the economy.

The problems are housing markets and the income relationship to value. Those are macroeconomic problems that are not solved only by targeting housing problems.

Senator CRANSTON. Senator Sasser had a comment, I believe, on this.

Senator SASSER. No, I just thought a moment ago that Mr. Butts wanted to comment on the question that I had directed to Mr. Papandrea.

Mr. BUTTS. Yes. It is heartening, Mr. Papandrea, that we are doing some of the things that you are talking about. I thought that we were sort of like all alone out there, doing some of those things.

We support the 3 percent down on some levels. We see the problems in it, as Ms. Cincotta talked about, but we support it in terms that it does make things affordable for low- and moderate-income people.

But the other part of the equation is that you want to have some kind of support to make the payment affordable. If that means subsidy to help make the cost of the housing affordable, then maybe that is something we should do.

The other thing, too, is that there has to be a counseling component to this. What we do, and the way our program works, essentially, is that we go out and flyer the neighborhoods with the "You need a house," they come to a meeting, we explain what the program is. We tell them that they are required to put in 40 hours of sweat-equity work in somebody else's house of the pool of houses that we have, to show us that they are sincere about what they are trying to do.

In the meantime, we require them to go to other ACORN and community meetings in the area in which they are going to be living, so that they understand that they are not just getting married to a house, they are getting married to a community. And we try to point them to other issues within their community that they will have to deal with.

Then at the same time, we are doing credit checks and counseling, and going through their budget, and talking to them with the bankers and interceding with the banks to try to make the loan and everything affordable for them. All that stuff happens.

We also require the people that go through our program to become part of the ACORN Land Association, which is a land trust, so that when they go to sell that property they have to offer it to the land association first. That keeps the house affordable.

We make sure that before they are tied to a particular property, that they understand this whole process, that they know that they are being tied to this house; that it does not really affect the ability to pass the property down or anything, but when they go to sell that property they have to offer it to us at a price of the improvements and the price that they paid for the house. So that house always remains a low- and moderate-income property.

We know, in terms of the value of counseling—because the two agreements that we have with Fidelity Bank and Continental Bank in Philadelphia, they are also participants in the Philadelphia Mortgage Plan. The default rate of the Philadelphia Mortgage Plan is, like, up here, and the default rate within the agreements that we have is, like, down here. It is under—we have had maybe three people that we had problems with.

But because of the relationship that we have with the bank, and the fact that people that go through the system sign privacy waivers, if there is a problem we can intercede and go talk to them and try to figure out what the problem is and let them know that there is a question of forbearance in a lot of cases.

We have to really teach people how to deal with banks, how to deal with the financial aspects of what is going on, so that they understand that these banks are not ogres, and that they want to do these deals, but that they have to be done in a certain way. And if you are having a problem, there are certain steps that you have to take to help solve the problem; that the bank does not necessarily want your house, they want you to pay back the money, you know.

Those kinds of issues we try to deal with, too.

Senator CRANSTON. Barbara.

BARBARA BANNON-HARWOOD

Ms. Bannon-Harwood. I want to respond first, real quickly, to what Gale said a while ago. I do not want us to mix up the need for downpayment assistance with the reason for failures of mortgages.

I think in a lot of cases, the reasons mortgages failed were that they were negative mortgages that were given to real low-income families with a lot of buy-down. So they qualified at $300 a month, and at the end of 7 years they were up to $700 a month, and they could not afford the payments.

I do not think that related to how much money they put into it. I think it was just a problem of the mechanics of the mortgages. So I think that is something to watch for.

But what I am hearing here, I am a builder in Dallas, TX, who is doing innovative public-private partnerships to try to solve these problems. What we have done is, taken all of these pieces that I am hearing you talk about today, and try to put them together so you address the total picture.

I do not think you can just talk about downpayments, and you cannot just talk about the mortgage amount, and you cannot just talk about problems with red-lining, you have to put the whole piece together.

The piece I have not heard you talk about is the energy efficiency of the house. Because once the family is in there, if their monthly payment is $400 a month, that is wonderful. But if they have to pay $200 a month in energy bills, utility bills, it will kill them. Then they will lose the house, too.

So my package includes—we start out with a counseling program, that they have described, and we work with families for like a year, saving the money. You get a pretty clear picture of a low-income family working with them over a year, talking to them

every month, about whether or not they are going to be a responsible, stable family.

You also get pulled into these issues that you asked about, about is there a crime impact from low-income families, and what happens to family stress when they are low-income. We get pulled into those issues as well, and have to refer them to other counseling agencies for those kinds of problems.

The downpayment assistance is a big question and a big problem. One of the problems is the coordination of departments over at HUD. There was a wonderful downpayment assistance program started in Dallas by Dallas County, and the lawyers at HUD have said that they are not sure it is a national purpose, that it fulfills a national purpose, so now they have said they cannot use block grant funds for that downpayment assistance program.

So there is some coordination that needs to be handled over at HUD. HUD is also questioning the soft second program that has been created out of—it is called the Low Income Mortgage Assistance Program. That attacks the mortgage amount that Gale talked about.

If you can help people with the downpayment, help them with closing costs, and reduce the cost of the house, and then reduce the cost of living in the house by making it real energy efficient, you have attacked the whole package and you have made the house truly affordable.

Mr. PEREL. Mr. Chairman.

Senator CRANSTON. Mr. Perel.

DAVID PEREL

Mr. PEREL. I am Dave Perel, of the city of Los Angeles, and we have operated homeownership programs through the mortgage bond program for 8 years.

I wanted to reinforce the last point. You really need all the tools. We found we cannot serve first-time buyers without FHA. Private mortgage insurance just will not work. PMI will not insure condos, will not insure homes in the central city, in Watts, or in East Los Angeles.

With the lowest price of $120,000, and the median $190,000, we cannot get access to FHA unless those limits are increased. So we need an increase in the FHA insurance limits. We cannot do a bond program without FHA, because that is the only insurance available.

Even with FHA insurance and bonds, we provide downpayment assistance. But you know, you are going from $120,000 down to $101,000 or $105,000, and you only have so many dollars. So you really have to pull all of the tools together.

Obviously, if you get insurance up to $150,000, whether they are paying 3 percent down or 5 percent down, it is still a big monthly payment, so you need the financing assistance as well.

You have to pull them all together. It is not either-or. I think the comments that get on that track are a starting point. Your proposal to increase FHA to 95 percent of area price is a good starting point.

Mr. O'BRIEN. Mr. Chairman.

Senator CRANSTON. Mr. O'Brien.

ROBERT B. O'BRIEN, JR.

Mr. O'BRIEN. Thank you, Senator.

I am Bob O'Brien, from Carteret Savings Bank. Representing the U.S. League of Savings Association. I am glad to hear Mr. Butts say that all bankers are not ogres. And you are right, we want the money back, not the house. We have previously submitted a statement for the record.

I think your bill is a good one. I would just caution that traditionally it is true that the lower the downpayment the greater the risk, and the counseling component is absolutely crucial.

I would be very cautious in lowering the FHA downpayment from 5 to 3 percent, unless and especially if there is a counseling component. That is absolutely critical. I think we have heard this all around the table today.

Also, raising the FHA limit, I think, while it might put more people in homes as lowering the downpayment would, I do not know whether it would keep them in those homes, because of some of the things that we have also heard.

There is certainly a critical need for help in the area of downpayment, and I think I would support the IRA option that you offer. But I would waive the penalty. I agree with Ms. Cincotta that, yes, the tax should be paid, certainly, but I think you could probably waive the penalty for early withdrawal if it were to be used for a downpayment or some worthy purpose of that type.

We have experimented in the past with many other kinds of downpayments, subsidized savings accounts, and none of them have seemed to have worked. But I think we need one, and I commend you for that option.

The costs certainly have been a big problem, and it is traditional to just blame the cost of money. And the cost of money has gone up in the last 20 years, from roughly the 6's to maybe the mid-10 percents. But as we have heard, the cost of the building of the house, the cost of the land, all of the other component costs have gone up even more, significantly more, particularly in our coastal areas. I think that is really a problem.

There has to be a shared attack on this affordability problem.

Mr. LACY. Mr. Chairman?

Senator CRANSTON. Forgive me for not getting back to you sooner, but a lot of people who had not spoken were seeking to speak.

Mr. LACY. Thank you very much.

What I have heard here is very important, in the sense that we were talking about programs that work because we address them to people, and to people's incomes and their affordability.

The problem that we are about to get into, if we expand the FHA program by loan limit, is that it is not going to help the people who need the help.

There have been some myths laid out here that I think I would like to talk about from a professional standpoint, in terms of understanding what drives home mortgage credit default risk.

Let me just pass out an exhibit, and I will take you through it very quickly. These pictures I think are important facts for the committee and for the Senators here to consider.

Senator CRANSTON. Could I say one thing about who needs help? I think people who are homeless need help the most. People who are near homeless and subject to becoming homeless at any moment need help next-most. Then, there are the special cases of large families, senior citizens, handicapped people, and families who need help.

Mr. LACY. Yes.

Senator CRANSTON. But I believe there are also those with pretty good incomes that just cannot afford housing, given today's circumstances. And we have to consider those as people who need help, too.

Mr. LACY. Yes, Senator, I agree. But I think it is important just to take a look at some of the statistics that we have developed over many years of experience, in terms of home mortgage credit.

What it shows is that low-income people pay their debts. They are even better credit risks than high-income people. We have statistics beyond a shadow of a doubt that show that lower loan balances perform better than higher loan balances. Now, showing that on the surface, you have to ask why.

Senator CRANSTON. That show what?

Mr. LACY. The charts show that our lower loan balances to lower income people perform better than our higher loan balances to higher income people.

What I have here are a few exhibits that show that raising FHA loan limits is not going to help the problem. The proposed FHA loan limits are in red. You can see the current loan limits adequately serve moderate income homebuyers.

In Los Angeles, San Francisco, New York, we indicate what a family of four at the area median income, police officers and school teachers could afford, and this is calculated using a third of their income. What kind of house could these people afford? You might make the comment that teachers are probably underpaid in America, but if you take a look at one-third of their income, what kind of house could they afford?

You see clearly by this graph that the current loan limits for FHA are adequate to address those people.

Senator D'AMATO. I have to tell you, at this point—is that the first page here?

Mr. LACY. Yes, sir.

Senator D'AMATO. I respectfully would suggest to you that—and I cannot comment for San Francisco, but I certainly can as it relates to the New York metropolitan area. I mean, you are showing slightly above $100,000. You know, I do not know where a person is going to buy that $100,000 home. You know, it is not there.

Now, it may be in certain areas, but certainly not to say the greater metropolitan area that you find these $100,000 homes for the school teachers, firefighters, young couples just getting out of school, transient workers.

I think Ms. Cincotta would tell you, you have got to really—they go to incredible lengths to try to find these $100,000 homes. And then you have heard people from the State mortgage agency tell

you that the way they are able to use the tax revenue bond so that you can reduce that cost by 2 to 2½ percent, the carrying cost, and you talk about monthly bills, is by when they have FHA insurance.

So now, if you have got a house that sells at $135,000, they cannot get the FHA insurance, they cannot get the mortgage revenue bond, and you put them out. So why not say that you are going to target the use of FHA to 95 percent of the median cost—or the cost of the house?

That does two things, where you have a high-cost area, it makes it possible for the State agencies then to use this technique, and you do not exclude them. It does not just willy-nilly do it across the country. So that if you have a depressed area for a period of time, whether it is Dallas—and we hope that is going to be cyclical and it is going to come back, or in Oklahoma, where the cost of housing is lower—then you do not give them this huge increase, but they get 95 percent of what the cost of housing is.

So I do not see how giving expanded flexibility is going to hurt. I think it is going to open up homeownership in a very logical way.

So we are not saying raise the FHA insurance limit willy-nilly, just make it $200,000 across the country, or $150,000, or $130,000. We are saying, no, look at the area and the cost of that area.

Now, would you be opposed to that?

Mr. LACY. Yes.

Senator D'AMATO. OK. [Laughter.]

Ms. CINCOTTA. Mr. Chairman, could I comment?

Mr. LACY. Let me explain why——

Mr. GRIBIN. Why are we using 1982 and 1983 numbers? There are statistics that are much later than this.

VOICE. I have those.

Mr. GRIBIN. These statistics are very old.

Mr. LACY. We will come to that exhibit—let me go through these. We have more current figures, also. This is from within our industry, and this is what our data people could pull together quickly. The other more current data also supports this.

But let me make the point, Senator, that we want to put more people in homes. We all share that common goal.

Senator CRANSTON. Yes, I know that.

Mr. LACY. And we want to keep them there. The issue of raising the loan limits on the FHA is not going to solve the problem.

Senator D'AMATO. Look, look, let me, also, if I might—please, and I hope you would bear with me——

Mr. LACY. Yes.

Senator D'AMATO. If you would yield just for this point.

I do not believe that Senator Cranston, myself, or any member of this committee, or any member of the staff, or any person here suggested any one component, like raising the FHA limits, is going to solve the whole housing crisis. Absolutely not. Nor the reduction of the downpayment, nor the use of revenue bonds, and the tax credits. And we could go into others.

But it is the totality. And we talk about the counseling, and we talk about taking a look to see that when you have a house you train people to make it energy efficient so you can save $100 a month for a low-income family as a result of this. So it is all of them.

So I only say that for the purpose of not having it construed that anybody—and I do not mean to speak for the chairman, but I know he shares this thought—we are not suggesting that any one aspect of this bill is going to solve the housing crisis in and of itself. We think it is the totality of these things that will help address some of the problems. And we are not even saying it is going to address all of them.

So I just thought that was important for the record.

Mr. LACY. Yes, sir. And here is my concern. We have limited resources in the Nation, and we have to direct those resources to the greatest need. Some of the actions that look to be expedient on the surface can drain some of those valuable resources.

Senator D'AMATO. OK.

Mr. LACY. And it is an issue of targeting those to people with the incomes, the lower incomes, who need the assistance. I can show you that those people are better credit risks. Properly structured, those people can afford housing and will pay their debts.

Where, on the other side of the equation, some of the larger loan limits have actually performed much more poorly, including some in the FHA portfolio, which is suffering some very severe losses.

The second exhibit speaks to an issue that says that, by taking the loan limit up, we are providing government benefits to higher income people. The people we are looking to assist are the $40,000 median income people who need some help. So the proposed loan limits, in that respect, will help the higher end, but do not help the lower end.

This is an issue that the other people down at the end of the table raised, and said, "Why don't we have more current statistics?" This data is from my industry, which has insured a lot of mortgages, compiled through a database that we have. In sharing data we have to be concerned with antitrust laws.

We have developed data for 1984 to 1985, and they exactly follow this pattern. This is a development that would surprise most people. The bigger loans in our portfolio have a higher incidence of default.

You have to ask the question: Why? Why would that happen? You will find that people, when given liberal financing, will buy a bigger house, will bet on the come, will look for speculation. Lower-income people buy shelter. They do not overstretch. As a result of that, we have seen in our portfolios better performance on the lower income, lower loan balance loans.

Regarding loan-to-value ratio as the key determinant to default risk, this has been proven by several empirical studies since FHA authorized one by Von Furstenberg early in the 1950's. We know of five or six studies done on this topic.

The amount of downpayment determines incidence of default. Regardless of income, regardless of loan amount.

Senator KERRY. Mr. Chairman, could I just ask one question?

Senator CRANSTON. Well, could I ask a couple of questions about the top chart, or make a couple of comments on it?

The bill is not proposing FHA limits as high as that chart shows. We are not proposing varying specific limits for cities, but for States. So you would not reach those high figures.

We do give authority to the HUD Secretary to devise different standards for communities with particularly high costs. That is for moderate- and low-income people. So I do not think we would reach those heights.

And many home buyers would have to be two-income families. So while the police salary, the teacher's salary would be there, there may be a double salary in a good many of those families.

Mr. LACY. Yes, Senator.

Senator CRANSTON. I want to recognize one person who has not yet spoken. Dean, over here.

DEAN WEATHERLY

Mr. WEATHERLY. Mr. Chairman, thank you very much.

I am Dean Weatherly, from Pinal County, AZ. Our county is located between Phoenix and Tucson. I commend your efforts in making housing more affordable in this country.

I do not have any fancy colored charts to pass out, Senator, but I would suggest that fairness is one of the things that we are attempting to address here. When it comes to fairness, we may be a small portion of a problem that is not too prominent elsewhere, but we cannot get our loan limits raised.

Now, we are a growing community in a rural county, a county that is five or six times larger than most eastern counties, a county by the way that could hold all of Rhode Island, all of Delaware, and half of Connecticut in its borders.

We have two communities that are nestled up against Phoenix, AZ, that have major problems because their loan limit is $101,250, ours is $69,350. We have tried on three occasions the last 2 years to get HUD to raise our loan limit, but the county size, territorial jurisdiction does not make that possible, because on the east side of our county we have a depressed mining economy where the mine company is selling housing at $20,000 a house. That is 100 miles away.

So I think fairness dictates that we have to have some amendments to FHA, that we expand FHA, and that we make it fair to these areas that are having problems such as ours.

We have some industries coming into our community. The executives for these industries are commuting 40 and 50 miles to Phoenix, because they can buy a house for $3,000 down, where it costs $15,000 to get an FHA house in our community.

So I think fairness is one of the things that you are attempting to fix with these loan limits, and I would appreciate any opportunity anyone could give us to help get this thing squared away before this bill comes. It is causing a leadership drain in our community, and it is a matter of fairness.

I think affordability is what we are talking about.

Senator CRANSTON. David Balcer.

DAVID W. BALCER

Mr. BALCER. My name is David Balcer. I am with the First Financial Bank in Milwaukee, WI. I am here on behalf of the National Council of Savings Institutions.

If I may, I just wanted to talk for a minute or two about the experiences in Milwaukee in recent years, which certainly differ from New York or California, in that Milwaukee is a lower priced town when it comes to housing.

When you look at housing affordability, you really have to go to the surrounding economic factors. For example, Milwaukee is a city of about 600,000 people. The metropolitan area is about double that. In the last 8 years, we have lost 50,000 manufacturing jobs that paid an average of $27,000 a year, and picked up 55,000 service jobs that pay an average of $17,000 a year.

So in rough terms, that is 15 or 20 percent of the market. The households have lost 30 to 35 percent of their income, because of the changes in the manufacturing base of the town.

Second, which is the obvious point, if you compare things any way with 15 years ago, once a person has a house—rates then were 7½, 8 percent, and now, although they are coming down, they are around 10½ percent. So again, with the lower income in a large segment of the community there is difficulty on the payments.

Third, and which has been talked about here and there in the room, when you look at Milwaukee and a lot of other cities that size, a lot of our housing stock is 60, 70, 80 years old. So for housing programs to work in Milwaukee, the efforts have to be directed at rehabilitation of the houses and the cost of rehab, and then to some extent filling in with new houses as older houses are torn down.

With that as background, the one thing that I personally like best about the bill are the provisions on the housing opportunity partnerships. In that regard, Milwaukee has started to get those off the ground.

If you have that type of program in your bill, it reinforces what we are doing, and it tailors the effort to our particular needs.

We have, just 2 weeks ago, formed the central partnership in Milwaukee. A combination of the Government and the financial institutions and business institutions and the churches and the neighborhood groups, collectively formed a nonprofit organization called "Milwaukee Neighborhood Partnership Inc." This organization will have four components, one or two of which are in existence.

One is, there is a nonprofit development company which will be directed at rehab and rehab costs. There is a revolving loan fund that the financial institutions created 2 years ago with the city and with the electric company. It is just getting off the ground. This I want to talk about, because it gets to finding techniques to apply to come up with lending at lower interest rates, and giving loans to organizations and individuals who otherwise just would not get in the door.

This program has $1 million of city money, which in essence guarantees the loans on city properties. The financial institutions put up $4 million in funds at cost of funds, say 7½ percent. The electric company, which somehow is a driving force in Milwaukee in housing, put up $2 million at zero percent, directed at the weatherization, and energy efficiency aspects.

And then, the city found another $5 million at 2 percent. This to me is a component of the type of partnership we need in our type

of city, and that you need elsewhere, in order to get to people whose incomes are declining, or who are living on the margin.

The organization has to this point lent about $3 million in the first year of operations. It is now lending at the rate of about a $½ million a year. We are working on ways to expand it, so individuals can get loans in cases where their credit background is OK but their income just does not make it.

So in any case, we do not, in Milwaukee at least, have the problem the houses being too high in price. In fact, last year the assessed value of the houses in the city went down an average of 5 or 10 percent, because it is getting older, because of perceptions about the school system, because of perceptions about crime. You can get a really comfortable house for $50,000, $55,000 and—it is going down in value.

What we need to do, and what we will do through this partnership, is slowly work on the neighborhoods, and slowly just sort of enhance their value, make them more desirable and try to get people back into the city or get them to stay and add to improving the basic structure.

Beyond that, there were a couple of other comments. My concern on the FHA part of this bill relates to the downpayments. I think—and I am talking from our experience, which is what you wanted to some extent here—where the prices are stable and are going down slightly, if you lower the downpayment requirement from 5 percent to 3 percent, you are inviting people into situations where in 2 or 3 years, unless we are doing other things, they may have lost that equity. That does not make sense.

I think the (401)k and the IRA account method is one of the approaches to do it. We have to find ways for people to save up and raise that 5 percent downpayment. It is through that, it may be through cooperative housing efforts that are beginning to take off in Milwaukee, it may be through employer-employee fringe benefit type programs.

But in any case, for myself and for the National Council, we certainly support the (401)k and the IRA aspect of this bill, and we are less inclined toward lowering the downpayment.

Following up on another comment over here with the question about the cost of housing, that too I think might be addressed more in the bill. There is a reference to it briefly that I saw at Section 105B4. Apart from building lower-cost housing, again, when you go back to a city of Milwaukee's type, we have to find ways to do rehab at lower costs. We have to find ways to do that through cooperative efforts and through partnership efforts, because we have seen situations where they have taken a $25,000 house and put in $30,000 of improvements, and ended up with a $35,000 house. I mean, that is just not good use of our money.

Senator CRANSTON. Shirley.

Ms. WISEMAN. Senator Cranston, I would like to address Mr. Lacy's data. I certainly understand, with the history of the PMI's, his concern over the soundness of the fund and spreading the risk. But I have in my hand data that was given to me yesterday at the Department of Housing and Urban Development that shows that loans under $50,000, $49,000 and under, have as much as 4 points higher claims ratio percentage than those $90,000 and over.

So I would challenge that data. It looks like maybe HUD has done some conscientious underwriting. So I would say that their experience has not been the experience of the PMI's, according to their own data.

I believe that we certainly need to make FHA available for all areas. I would like to go back to that policewoman and her husband, the teacher, and just reinforce the fact that it is two incomes that buy housing. Those people in California that we were referring to could buy a home with two incomes, combining those incomes, but they would not have the $30,000 or $40,000 at the $101,250 limit that we have now. But they could buy a home—not necessarily the $188,000 median price, but they could qualify for the $145,000 to $155,000 loan.

Senator CRANSTON. Mr. Edelstein.

Mr. EDELSTEIN. I think that fairness does require that there be some consideration of periodic adjustments for regional differences in real estate markets. I think that is very clear. But you should also recognize that that attempt to have equity is not done without cost, and there are risks involved. And I would like to lay those out.

First of all, any time, as has been pointed out, you increase loan-to-value ratios, everything else being the same, you increase risk. People talk about being in hot markets, I remember them talking about it in the early 1980's being in Houston. Hot markets turn to cool markets. And, if you basically are using non-recourse financing and you are giving out loans that have very low downpayments, whoever is insuring is running risk. OK? That is the first point.

FHA will increase its risk portfolio, I think, by introducing these regional differences, but it may be something that they want to do and should do, to reflect regional differences.

We also should be concerned about whom we are going to help. In California, I did some rough calculations, you take a 30-year mortgage of $180,000 at 10½ percent, that translates into $1,646 a month, which means, using traditional debt service income standards, you are talking about a household with a $70,000 income as being eligible. You may or may not want to help them. In California, a household income $70,000 may be equivalent in purchasing power to a much lower nominal income when compared to, say, Louisiana because of housing prices.

Finally, you should also recognize, if you increase the availability of financing, you are effectively increasing demand. It is equivalent to saying everyone at this table has a little more money to pursue housing. Unless you get a supply response, there is going to be solely price response.

Even with a supply response, there will be probably some price effects.

Senator CRANSTON. Willard, you have been seeking recognition.

Mr. GOURLEY. Well, I wanted to go back to counseling for a minute, since it has been mentioned. Mortgage bankers think that is a very, very important ingredient in any program.

One thing that concerns us about the bill, though, is the inability to provide counseling in all areas of the country. So we would need to include counseling as some part of the bill, and we need to recog-

nize that in some areas it is not going to be as available as in others, and that could slow down the process and create some problems.

We are very much for it, but like Ira was saying about averaging, you know, there are some places that just cannot handle it that easily, and it could restrict the market there. But we are very strong supporters of the counseling. We wish that we had had it for the 235 program back when it went into being, but it was not properly funded, and there still are not enough counseling units, counseling agencies out there to cover all the country.

I just caution, we need to be sure and recognize it, and not just put a carte blanche counseling requirement. We have got to adjust it.

Senator CRANSTON. Yes, Gale.

Ms. CINCOTTA. I wanted to submit this. It's two sheets of paper. The top one says, "Townhouses from the low 80's." It is from the Washington Post, February 1989. FHA increased their limits in March, and the next month you saw the same townhouses "from the mid-90's." OK? I want to show you that, and put it into the record that FHA causes price appreciation.

When you talk about low downpayments, we are not adverse to 5 percent down, especially if it is conventional, especially if it is PMI. When you talk about FHA, you are talking about HUD. I have spent probably 25 years of my life trying to get them to do us no harm.

You are talking about a big institution, and you are talking about national policy. You are not talking about regional differences. You are talking about an institution that, under HMDA, is supposed to disclose all the FHA mortgages. They have never once done it, never once looked at it themselves.

You are talking about an institution that has closed most of their area offices, so you are talking about a program that you are trying to tailor for this area or that area; and you are talking about this building in Washington with a few folks out there who still are not answering their phones. You know, Secretary Kemp said, "Now our phones are being answered."

You are talking about giving an institution more power that does not monitor the loans it has made already. We had to fight to expand one prepurchase mandatory counseling program, the only one in this country that I know about, in Chicago. We have tried to get them to expand it into an area of four-by-six blocks that has over 300 abandoned FHA good, solid, brick single family and two flats. They will not do it.

You are talking about an institution that you have asked to monitor: Where are the high foreclosures? Who are the mortgage bankers that are writing that paper? Decertify them. Who are the realtors that are coming in with this 100 percent insured paper? Cut them off, too. HUD will not monitor that in any way.

That is why you do not have paper that most savings and loans and banks put out those loans. The programs look good on paper, and it sounds nice when you enact them, but the manner in which they are handled is what is so sick.

Get HUD to disclose, get them to put in mandatory pre-purchase counseling, get them to do all of that. Get them to cut off the bad

apples that are using our tax dollars. Put in the repair and sell program.

Increase the mortgage assignment program. We won it through the court fight. The judge has held HUD in contempt year after year, because they do not want to enforce it, because they want to put the temporary mortgage assistance program in instead.

So it is not what you want to do, it is who you want to do it with, and who you are going to get them to do it to. That is the problem.

Senator D'AMATO. If I might ask some of the mortgage bankers to respond, because I think that Gale has touched upon some excellent points that heretofore I have never heard expressed so cogently, as they relate—and with such emotion, I like that. [Laughter.]

Senator D'AMATO. I am accused of a little bit of that, myself.

But as it relates to the disclosures, and cutting off and decertifying. You know, all you need are a couple of characters in this business, whether they be in the real estate side of it or whether they be in the banking side of it, who do not really care and are in for the quick buck.

What would you say to some of the things that she discusses? Is there anyone who opposes any of them, or anyone who would like to comment on that?

Mr. GOURLEY. A couple of things, Senator. I have covered the country over the last 2½ years as an officer of MBA. I find that most of the country is well served by HUD offices. I mean, they do respond, and do a pretty good job from that standpoint.

Obviously, at that point there are some bad apples—that is, some people do not respond as early, some of the HUD offices, as early as others. But from that standpoint that is——

Senator D'AMATO. I am not talking so much about HUD, I do not think Gale is, in not responding as such, and being bad actors; but that there are a number of bad actors in the real estate side of this, as there are in any area, and in the banking side. We have got to see to it that we are really vigilant in undertaking and seeing to it that there is the proper screening, the proper enforcement. And where you find the pattern that has developed, you root them out, because they hurt everybody else. They hurt the 99 percent of the legitimate real estate and the legitimate mortgage providers.

They really hurt, then, the working families who otherwise might have an opportunity, but have a program so severely hurt and scarred that people pull back, so they do not get an opportunity.

Isn't that the point you are trying to make, Gale?

Ms. CINCOTTA. I do not know if you can get those institutions called FHA and HUD to do that. They refuse to do it all the time.

The problem with FHA and HUD is that they do not know how to deal with the client directly, like the social security or welfare. They rely on the realtors, the builders, the mortgage bankers, and everybody, to get to their client. Therefore, they have got to write their stuff to suit them.

So they have never figured out how to get—I am FHA, and you are my client, they have to operate through all these folks. They are buddy-buddy with them, to get them to push their paper. And then you say, "Now you have got to monitor them." We had to go to the Justice Department to get the indictments that we got on

inspectors and the real estate appraisers, realtors, mortgage bankers. We had to go to the Justice Department to do that. And we did it across the country.

Senator D'AMATO. I think you are going to find, though, Gale, if I might make an observation—I think you are going to find that under Secretary Kemp you are going to find a much more responsive—I really do—kind of office.

But your point is, let's learn from the past mistakes, let's see to it that we have that kind of situation. I would very much appreciate your putting in some suggestions in writing.

Ms. CINCOTTA. It is in my testimony that has been submitted.

Senator D'AMATO. Yes. Because I think you make some very valid points.

Mr. Hodge.

Mr. HODGE. I hope you will excuse me for being a bit one-way, but I do want to get this point out, and talk about the price of homes that Mr. O'Brien is talking about. That is, what we do with mortgage revenue bonds, aside from the fact that we are, perhaps, a couple of points below the conventional market.

By taking the bulk of those bond issues and raising them just a fraction in return, we take a small amount and reduce the interest rate on those bonds significantly. We work with nonprofit organizations that bring together self-help groups that build their own homes.

We have, in California, done a lot for the price homes that Mr. Morris was talking about, at $40,000, $50,000. And I mention this because, when they talk about mortgage revenue bonds, they seem to talk about them just in terms of 2 points less than the conventional market.

There is a lot of public purpose that is being done by State agencies, because basically they are entrepreneurial in nature, and have been very inventive in the things that they have done. I just wanted that for the record, so that we understand that it is just not 2 points less, but there are a lot of other things that are peripherally being done.

Mr. GOURLEY. If I could just add to what has just been said about HUD, and in talking about the staffing of HUD and the kind of service they provide and really looking at what they have been doing recently to help accomplish just exactly what Ms. Cincotta has said. As a matter of fact when I left my office in Charlotte, NC yesterday, we had HUD auditors in our office.

They are now doing an exceptionally good job most of the way around the country, in getting into mortgage bankers' offices and checking to see how they are functioning. This past year, or in 1988, lenders paid $35 million in—I would not call them fines, but in compensation to HUD, where HUD had found mistakes in just simple handling of items in the office.

So they are looking very carefully at it. And I, as Senator D'Amato, seeing that Senator Kemp—pardon me, Secretary Kemp. [Laughter.]

As he now is, is an activist, and is going to make certain this continues. So I think the oversight in these offices, because of the direction they will be getting, is going to make it much more effective. I think you are going to see a lot of it being accomplished.

Senator D'AMATO. Mr. Butts.

Mr. BUTTS. I know one of the things that has happened, the majority of the HUD homes that were sold in Philadelphia were sold to developers, and not necessarily to nonprofits. That causes a lot of problems for us. Because what happens is that we cannot afford to out-bid them.

What they ultimately wind up doing is creating more rental properties, and the rental properties are going for two or three times what we can sell properties for for home owners. We have people who are paying $600 a month for rent in north Philly because—you know, using section 8, or whatever. But there are even people who are really paying $400 or $500 a month for rent, where we are trying to produce properties that are selling at a mortgage payment of around $250 a month, which is a different animal altogether.

Senator D'AMATO. So you are saying, give greater access to the nonprofits, give them at least an opportunity. There has been a contention, and I have shared a certain feeling as it relates to giving this. One of my colleagues, and a distinguished colleague, and a good friend, offered an amendment on the Banking Committee that would have given first opportunity to the not-for-profits for up to 90 days.

I felt constrained not to support that, because I thought that what it would do is to take the properties and hang them kind of into limbo. It might also open up another kind of abuse situation, where there are some not-for-profits who do not operate, Mr. Butts, quite candidly, as yours and Ms. Cincotta's and others would, that utilize that leveraging for their own—not for real housing, but to get a payment from someone because they would then not go forward with the bid.

How do you handle this? Was my concern one that—you know, here we are, and we do have this housing crisis, and yet we do have this thrift problem with all of these properties in foreclosure.

What would you say? Do you think there is some middle ground?

Mr. BUTTS. I think some sort of a review process probably would help, with the people that are involved.

Senator D'AMATO. A certain percentage that maybe would be given first option, 30 days? You could make—could you make up your mind within 30 days on whether you were going to bid on the property or not? It would not take you 90 days, would it?

Mr. BUTTS. We are desperate for anything we can get. We run as soon as we see something. What they do is—we do not even know, half the time. We respond to the same ads that go in the paper that everybody else responds to, and just go down with a list of properties that are in the areas that we try to serve.

But in a lot of cases, what we are feeling is that HUD and FHA in a lot of cases just are not servicing our communities. It is the same thing with the attitude that I get over and over again. They do not want to deal with us, really, at all. Because we are talking about houses that are from $12,000 to maybe $40,000, tops. A lot of people do not even want to deal with those kinds of issues.

I mean, I realize that that is a regional kind of thing, but that happens a lot.

Senator D'AMATO. Yes.

Ms. BANNON-HARWOOD. With regard to Gale Cincotta's request a few minutes ago, I wanted to just throw out an olive branch, as a builder who started out as a low-income advocate.

I think there is a real increasing awareness in America among builders—and I see Mrs. Wiseman working on the problem on a regular basis at NAHB, and other people in the realtors' area—there is a real growing awareness that we have to work together.

I think this very process will provide some kind of forum for that, so that the bill that we eventually come out with here may answer some of your problems and solve some of the problems at HUD. If we have someone like Secretary Kemp, who seems to really care, then it will get some of the bureaucratic problems out of the way, and perhaps this very process will solve some of the problems you are talking about.

I would like to add, too, I would like to comment on something that Robert Edelstein said a moment ago. He said, when you increase the loan-to-value ratio, you increase the risk in all cases. And I would submit that that is not accurate when you do it for energy efficiency recognition.

I think that is the one element in this bill that is not there, and that definitely needs to be there. When you increase the loan-to-value ratio for families who are getting a very energy-efficient house, you are increasing their ability to make that payment every month.

That is the one thing I see in none of the titles in your bill, and I think it is vitally important.

Mr. EDELSTEIN. I did say increasing the loan-to-value ratio with everything else being the same, cateris parabis, will increase risk. So I think you are misquoting me.

Senator CRANSTON. Mr. Papandrea.

Mr. PAPANDREA. Thank you, Senator Cranston.

I would first like to endorse your enumeration of your own priorities as being those of the State of Connecticut. And Senator D'Amato, your appeal for fairness, I would like to re-echo that, because I think there is a paramount need for balance and perspective.

I do not like what appears to be a pitching of one group against another group, based on income. A big part of our housing problem in this country has been what, in effect, in many States has been segregation because of housing by income alone. I would like very much to get away from that, and to try to get to some balance. Because many of the people that are in that $60,000, $70,000 bracket today come from families that labored long and hard in the much lower income brackets. That is the hope that we have: to elevate people and get them out of that low-income area.

But the one thing that I do want to emphasize is that there is a very real economic impact if something is not done to address the needs of those who are in the $50,000, $60,000, $70,000 area as well.

We in Connecticut are now experiencing in our business and industry attempts to recruit people into our State as employees, with a 55- to 60-percent rejection rate. And I am sure that this is not true only of Connecticut, but of any of the areas that are impacted similarly by the escalating costs of housing.

I would urge you that there is obviously a need for balance, and always a need for the structuring of priorities. But I do think that those priorities can be addressed, that certainly the first priorities are evident to all of us; but that the other end of the scale in States that are impacted has also got to be increased.

Last, let me say that the people that I asked for opinions prior to coming here on the increase in the FHA limits—in Connecticut, the reaction that we received was that, if they were to be increased, obviously it would be a god-send, because a $101,000 limit in the State where the average price is $169,750 is very, very much needed.

The other part of the problem that we have in Connecticut is, the amount of resource that as a State we can make available to get people into homeownership. The reaction we have gotten is that, if the limits were to be increased and the amount of FHA mortgages that would be available were to be increased, it would in effect take the pressure off of the amount of money that we now devote to the targeting for low-income downpayment assistance programs.

That is what we get back when we ask people for their opinion.

Senator CRANSTON. Mr. Hodge.

Mr. HODGE. I wanted to just comment on Mr. D'Amato's remark about the thrifts. I think that, if you have got the housing finance agencies throughout the country out of the private activity cap, they could move in very rapidly in working with savings and loans and pick up that inventory that is there at discount, and put it out to folks at prices that would be very palatable.

You have got a network out there that understands that, there is expertise, and they could do a good job in that regard.

Senator CRANSTON. I would like to have us address another concern that was raised by Gale. That was that some whole neighborhoods or communities allegedly have been destroyed by FHA.

First, I presume much of that occurred when the FHA ceilings were not this high. So it was not in an era of these very high expenses. But second, how much of that related just to the fact that FHA loans were available? How much related to the way they were administered? There may have been some very bad handling of FHA's procedures in places where that occurred.

In any event, what were the causes? What are the cures? How do we prevent it? Because FHA does exist, and we certainly do not want FHA destroying neighborhoods.

So she made her statement, and I think we all heard it. Does anyone want to make a comment before Gale comes back with her comments?

Yes, Mr. Balcer.

Mr. BALCER. I would just say, again from our experience in Milwaukee, we have found recently, there were some cases of fraud a few years ago. We certainly have to be vigilant on that. But now both the lenders and the brokers are complaining that FHA is underwriting too strictly.

I really do not have a lot to say on that, except just that that is our experience, and we have some offices in other cities who are experiencing it too. It just does not make sense, regardless of limits, for FHA to underwrite on a stricter basis than financial in-

stitutions would recommend. That is cutting off low-income people from getting housing.

Senator CRANSTON. Any other comments on that point?

Yes, Mr. Gourley.

Mr. GOURLEY. Just that in many of the States, FHA is the only source of insurance or the loans, and so they knew that they would get involved in some of these areas where no one else is.

Senator CRANSTON. Yes, Mr. Butts.

Mr. BUTTS. In terms of FHA, what seems to be happening for us, at least, is that it seems like it is a cycle, that FHA follows what the banking industry is doing. And when the banking industry started to red-line, then they started to red-line, too.

Part of that is starting to break down now, but it does not seem like FHA is necessarily keeping up with some of the things that are happening in the banking industry, and to sort of break down the underwriting—underwriting is extremely important. That is one of the first things that, when we started structuring these agreements around the country, we started to see.

With the underwriting, what you have to really do is to make it so that people are dealt with on a level they can be dealt with on. So the underwriting is paramount, in terms of what we can do.

Senator CRANSTON. Yes, Mr. Morris.

Mr. MORRIS. Senator Cranston, I know I am the only little manufacturer of manufactured homes in the room. And being from Dryden, MI, with 540 people, there's more ties in this room than we've got in all of Dryden. So I'm a little out of place. [Laughter.]

Mr. MORRIS. But I do have one thought that I would like to leave with you. Fairness, like Senator D'Amato said, is a great word. And in Michigan, I mentioned, we will sell 11,000 homes this year built in a factory, and we——

Senator D'AMATO. How many in New York?

Mr. MORRIS. 4,600, give or take 40.

Senator D'AMATO. Are you breaking down some of those codes?

Mr. MORRIS. Pardon?

Senator D'AMATO. Are you breaking down some of the resistance, the exclusion?

Mr. MORRIS. Yes, sir, we are. The codes in New York really hamper us. And what happened in Michigan that made it great was, they put in some 12 years ago, with no input from our industry, it just happened—there was a manufacturing or a mobile home commissioner who put it in. Now, when people zone you out, we have got a way to turn, to find someone that can say, "Hey, it makes sense," or "It doesn't make sense."

Do you want low-income housing? Do you want young people living in your town? Or, are you going to price them out with housing that starts at $90,000 and goes up, and that they cannot afford?

If I had my magic wand, or some magic dust, if I could get that same guy at HUD that was interested in promulgating housing for low- and moderate-income people, and that would help us when we have zoning problems or State problems, we could make a dent in this problem. Because I still come back to you, we can put houses out there that everyone in this room would like, for $40,000.

Senator D'AMATO. You see that picture there?

Mr. MORRIS. Yes, sir. I have got a hundred of them, sir. [Laughter.]

Senator D'AMATO. I'll bet you have got more than that, too.

Mr. MORRIS. Yes, sir, you are right.

Mr. GRIBIN. Did you bring along any contracts? [Laughter.]

Mr. MORRIS. Sir, you know, you would not cash—we could not get you to bank. [Laughter.]

Senator D'AMATO. How many square feet is that particular one?

Mr. MORRIS. That is 1,460, sir.

Senator D'AMATO. And what does that sell for?

Mr. MORRIS. Well, now see, the words I learned—let me not dance around——[Laughter.]

Senator D'AMATO. I want to buy one, you know——

Mr. MORRIS. OK, I am going to get you in.

Senator D'AMATO. After all, they are going to take away our honoraria, and——[Laughter.]

Senator CRANSTON. And reduce your pay——

Senator D'AMATO. Reduce our pay and take away our honoraria. [Laughter.]

Mr. MORRIS. All right. Now, its location. This home is pictured in North Carolina on a golf course. It will sell for $90,000. The same home in Charlotte, some smaller towns, Rock Hill, SC, $39,000.

Senator D'AMATO. Let me play the lawyer——

VOICE. Land costs?

Mr. MORRIS. Not land.

Senator D'AMATO. OK, let me play lawyer. I just want to try to get—I was never too good at that, and that is why I went into politics. But anyway——[Laughter.]

Let me ask you this.

Mr. MORRIS. And you have been very good.

Senator D'AMATO. No, I have been getting my—knocked off lately. [Laughter.]

But let me ask you this. Is that the upper end of your price, the picture you showed us, about 1,400 or 1,500 square feet and about $40,000? Is that the upper end of the manufactured homes that you have?

Mr. MORRIS. For Champion. I am showing you my company, yes, sir.

Senator D'AMATO. OK. You know, this is not a trick question.

Mr. MORRIS. No.

Senator D'AMATO. And so, without land, you are saying that the cost is $40,000, right? For the basic house. And then it is plus whatever the cost of the property is.

Mr. MORRIS. That is true. But I added all the amenities.

Senator D'AMATO. All right.

Mr. MORRIS. I mean, I am giving you everything.

Senator D'AMATO. No, no, I'm not—— [Laughter.]

So you are saying for a super-deluxe house——

Mr. MORRIS. You got it. You got it.

Senator D'AMATO. You have air conditioning in there, too?

Mr. MORRIS. Yes, sir.

Senator D'AMATO. Boy, that is—we start off—that is better than mine. Maybe we can make a trade, huh?

Mr. MORRIS. The house in your neighborhood will not sell, sir. No.

Senator D'AMATO. How do you know that? [Laughter.]

Anyway, my neighborhood is a hot neighborhood right now. [Laughter.]

VOICE. What does that mean?

Senator D'AMATO. I tell you. I don't even think I can go home tonight. [Laughter.]

But now listen. So it is about $40,000 and you have got it from soup-to-nuts. What is it? Two bedrooms? One bedrooms?

Mr. MORRIS. That particular model is two-bedroom, two-bath, jacuzzi, a fireplace——

Senator D'AMATO. All right. Now, and then you have got your sewer hook-up, your electric hook-up, right? So that is extra?

Mr. MORRIS. No, sir, not in that $40,000.

Senator D'AMATO. Not in your $40,000? In other words, you will hook up the electric, providing that there is electric on the plot?

Mr. MORRIS. Not me, personally.

Senator D'AMATO. And the sewer——

Senator CRANSTON. He will not do that personally.

Senator D'AMATO. All right, well, he will not personally, but that is part of the cost.

Well, that is not too bad. So if you, in certain areas where the land cost, depending upon what the cost is—what size plot does that go on? Does it go on a 40-by-100?

Mr. MORRIS. On a 60-by-100.

Senator D'AMATO. Sixty? That is big.

Mr. MORRIS. Well, it can go on a 40, turning it around. But you are asking about a specific home.

Senator D'AMATO. Well, where I live, most of the plots are 40-by-100, believe it or not.

Mr. MORRIS. We will turn the front entrance around, sir. It is just particular one.

Senator D'AMATO. Well, I am not suggesting that. I will get another newspaper story. At a hearing I decided that I just want to try to figure this out. [Laughter.]

Senator CRANSTON. I am going to announce we're taking this show on the road. [Laughter.]

Senator D'AMATO. So 60-by-100——

Mr. MORRIS. Yes, sir.

Senator D'AMATO [continuing]. Is it basically. What about financing? Can you get or do you qualify for FHA financing?

Mr. MORRIS. Yes, we do. But what happens, in the secondary market, there has never been a real good place for us to put our paper through. So we strangle.

Senator D'AMATO. OK.

Mr. MORRIS. The Senate and the House have granted FHA the approval to do these things——

Senator D'AMATO. Yes.

Mr. MORRIS [continuing]. But it never happens. It is like HUD. We have lots of great rules——

Senator D'AMATO. Are you suggesting that FHA could help facilitate this kind of production with a greater recognition, or some relaxation of rules, or implementing rules that will help?

Mr. GOURLEY. A manufactured home, placed on a lot that is a piece of real estate, and we make FHA and VA loans on those, and put them in Ginne Mae pools. And we do it all the time in the great State of North Carolina.

Mr. MORRIS. Yes, sir. I am telling you, though, sir, that across this great country of ours it is such a minute part that it—it means nothing. Furthermore, there is no secondary market for conventional loans although Congress has given FHLMC and FNMA the authority to do them.

Mr. GOURLEY. OK. I just wanted to say we can do that.

Senator D'AMATO. OK. So what Mr. Morris is saying—and then I am going to stop, and I thank the chairman for his indulgence. I had a chance to have a little bit—get it off my chest. But what you are saying is that this is an untapped resource that can provide some housing that is not the stereotype trailer park, that is permanent housing, yet it is lower in cost and production, and also should be part, wherever practical, of the national housing strategy?

Mr. MORRIS. Yes, sir.

Senator D'AMATO. Is that a fair statement?

Mr. MORRIS. That is.

Senator D'AMATO. All right. I will stop with that.

Mr. MORRIS. And I am going to have everybody in our plant in New York vote for you——

Senator D'AMATO. Don't say it. I'm going to get in more trouble. [Laughter.]

Mr. MORRIS. OK.

Senator CRANSTON. Let me add one point that is relevant to what you are saying. The bill does require participating States and localities to identify all sorts of problems that affect housing prices. We cannot override local decisionmaking processes and zoning, but we can point the finger, raise the debate, and maybe lead to steps that can deal with the problems you are talking about.

Mr. MORRIS. Like withhold the funds?

Senator CRANSTON. Well, we may be able to consider some conditions. But we cannot get into the Federal Government running roughshod over local decisionmaking processes. We have to have some balance.

Mr. MORRIS. And we understand that, and we are appreciative of the efforts that you are undertaking to give guidance to State and local governments.

Senator CRANSTON. Thank you.

Mr. Perel.

Mr. PEREL. Let me jump back to something that was brought up before by Mr. Edlestein and Mr. Papandrea, the high-cost areas and the effect on the economy. I think the same thing is happening in Los Angeles, where employers are having more and more difficulty attracting employees, because they cannot afford to relocate there.

Moreover, that is a source of the housing problem. You have a growing economy, and it is driving up prices. This relates to your proposal on retirement accounts, (401)k's and IRA's.

That by itself, I am afraid, is not going to be enough, because the first-time buyers are not going to really be saving enough in those accounts to do much. Why couldn't you broaden that proposal a bit,

and structure some sort of a matching proposal where employers who are willing to subsidize the downpayments of first-time buyers might then be able to permit their employees who are not first-time buyers to use their retirement accounts, the same way you propose for first-time buyers.

I would suggest a matching proposal where you really facilitate a partnership, because so much of our housing problem is caused by imbalance between employment and housing prices.

So I would like to suggest that maybe you broaden the proposal in a way that really does not increase the revenue impact, and you really create a matching program for employers locating in Connecticut, or in California, where you have high-cost areas.

Senator CRANSTON. Can I get to a slightly different point? We have covered many of the topics that were in the discussion guideline, as we have moved around. But there are a few points I want to make sure that we do cover.

One is, how do you assess the provision that gives FHA more flexibility in deciding what sort of adjustable-rate mortgages should be insured? What amount of disclosure or counseling is necessary to ensure that consumers are not unduly burdened by unexpected increases of monthly mortgage costs under an ARM?

Do you have any advice on that aspect of the legislation?

Thank you very much, Al. I appreciate your cooperation.

Mr. O'BRIEN. Yes, Senator. Thank you very much.

The key to your question, I think, is the counseling component. That should take place at the point of underwriting, and be part of the underwriting process.

One should not underwrite the loan at the lowest point in an ARM cycle, which is generally the point of origination. You should underwrite the loan as if the rate would escalate at least 200 basis points. Because if you do not, you are going to run into trouble when we do have escalating rates. And rates are inevitably going to rise as well as fall.

Senator CRANSTON. Do you have a comment on that point?

Mr. O'BRIEN. I would generally agree that the ARM flexibility feature is a good option to add into the financing component.

Mr. GOURLEY. We concur, right. Yes, and also with the underwriting in the second year rate or the payment rate rather than the first. It is very important.

Senator CRANSTON. Two other specific things I would like to get into.

One, there is a general agreement on the desirability of people to get into Government-assisted low cost housing and having an opportunity to develop an ownership of that housing.

I know that that is a thing that Jack Kemp, with whom we have been working as closely as possible—and that is quite closely—feels very strongly about.

At the same time there is a desire not to let those people sell it and get it out of the stock of public housing and reap a very handsome profit.

How do you combine the opportunity of ownership while limiting the profit that could be made and keeping it in the stock of public housing?

Yes, Barbara.

Ms. BANNON-HARWOOD. One of the successful things we have done in Dallas is create this low income mortgage assistance program, which is a 15-year soft second, and if they stay in the house it is forgiven, and if they sell the house, they have to pay it back. And for families that we sell to, which earn from $14,000 to $28,000, less than 80 percent of the median, and a lot of families in the 50 percent of median area range, they are usually in jobs—they work at the ceramics factory that is not too far away or places like that. So there is neighborhood stability in terms of jobs, and there is an incentive to stay in the house because they don't have to pay that back if they don't move out.

So we are hoping that works.

There is also a program in Dallas for a land lease of 99 years with a nonprofit to do that.

Senator CRANSTON. Gale.

Ms. CINCOTTA. On public housing I think it is looked this way if you can make these folks homeowners there is no need for public housing. The truth is that public housing people change. There are new poor, newer lower income folks who need housing, so that the danger of selling it off without a replacement, physical replacement, building for building, as opposed to selling off the building, giving somebody a voucher to use on the open market. It doesn't make sense that after we have been here 2 hours talking about the problem that there is no alternate housing available.

So that I think you have to look at it this way. There will always be some folks who are going to have the problem of losing their job and needing public housing, or having a illness or whatever, so that selling off public housing is wrong—it is the one continuing obligation of the Federal Government. I think Jack Kemp wants to dump it—and to say that now it is going to be the private market's problem is wrong, I don't think you should sell it off. I think you should help folks in public housing get into other housing, so that their units will be available for the new poor.

Chairman CRANSTON. Well, if you can't sell it off, how do you own it?

Ms. CINCOTTA. You get people who are in that property—public housing—now into a homeownership program get them in housing that they can afford. But if you sell them the units where they are now living, then you have to replace it, one to one, with new buildings. If you sell it off and don't replace it, then there is no place for newer poor to go into.

While you are trying to better the people already in public housing, remember it is not a constant, also I would bet, in Robert Taylor homes in Chicago, where there's 45,000 people in public housing in those tall buildings—and when I was Chair of the Women's Commission in Chicago, we did a study. Eighty-seven percent of those families in public housing in Chicago were single women head of households. Seventy-five percent of the people in public housing were under 21.

Would you really be doing those folks a favor by keeping them there all together where the schools are on the second floor, the stores are on the first floor, and they never get out of the neighborhood? And now tell them they should buy these units. I question that unless it is scattered site housing you don't want to keep

people in that condition. Before they were having problems as renters. Now they are owners and they live in that same situation. So that I really worry about where public housing is going. Right now the nonprofit world is dealing with what the public housing officials should be dealing with. The public housing numbers are going down and down, and if you sell them off and you keep them in that same area or you don't replace them physically with new buildings, you are putting more problems into the community, just getting the Federal Government out of it.

Senator CRANSTON. Yes.

Mr. PEREL. As in Dallas, the City of Los Angeles has a homeownership program where we assist first-time buyers and the same issue about windfall, and there are many ways to really control that.

First of all, they are restricted to reselling the home to the same income groups, and that is one way it protects against windfall.

Second, we have a shared appreciation mortgage. When the home is sold down the line we have terms where it is either half the appreciation or 7 percent simple annual interest, whichever is less. It gives the buyer a chance to share in the appreciation, and at the same time we are recapturing some of the money we put in as downpayment assistance.

I think there are many ways to deal with the problem, and the important part is getting that tool available on a more broad scale.

Senator CRANSTON. Can I ask another question? What incentives could be written into the law to encourage FHA to continue and expand services to lower cost housing markets?

Mr. HODGE. I think they have a program that perhaps insures seconds. This would be addressing the preservation aspect of it. And again I think finance agencies could come in with seconds on refinancing some of those projects that would give the owner cash that he really wants out of it and at the same time keep that inventory in stock. And I think that they may currently have a program that does that. I am not sure, Senator Cranston.

Ms. CINCOTTA. There has to be more money in HUD to tie all these pieces together. For example, we have been able to get a lot of CRA agreements where we for the first time have gotten lenders into doing low income housing. Because the appraised values in these neighborhoods are lower, the banks can only lend a piece of project costs. You need a slow second mortgage coming in, which we now get through CDBG money.

There should be a way to guarantee a larger part of what the bank puts in, as much as the rental income say in a multifamily rehab or new construction would cost. There has got to be more funding for soft seconds and slow seconds. The CDBG money should be targeted so that 75 percent of it goes to low and moderate incomes so it would be used for that. The money you get from slow seconds reinforces the banks and savings and loans coming in and doing the rest of the deal. They keep the Federal Government or the city from having to do it 100 percent themselves.

There is not enough money from HUD for that. So that would be a help, more write downs, something to share that cost so that you get the private sector in, and I think that is going to be the trick. How do you leverage HUD's money? How do you get HUD to lever-

age out conventional money, using guaranteed soft seconds, or writedowns whatever it takes to make it happen.

Senator CRANSTON. Shirley.

Ms. WISEMAN. Mr. Chairman, I would like to suggest that one of the ways that we can provide more affordable housing is in the HOP program somehow if we can tie in regulatory reform so that we get some of the regulations that have piled on each other for years.

I have been a builder for 25 years, and I haven't seen any regulations lifted. The joint venture for affordable housing that HUD has started, it could move significantly forward and make giant strides to addressing the problem of affordability, and if we could just somehow tie the HOP program to regulatory reform at the local and State levels, it would make significant strides, and I would suggest that we include that.

Senator CRANSTON. David, may I just make a comment to you and your interest in your employer-assisted housing? Would you explore with our staff after this your thoughts on that?

Ms. BANNON-HARWOOD. Senator, I just want to add real quickly that FHA does not allow you to give an FHA/VA mortgage to somebody that has a soft second on it. I think that is a big problem.

Senator CRANSTON. On the concept of permitting FHA to insure up to 97 percent of the value of a home under some circumstances for first-time home buyers with counseling, there is concern obviously that has been expressed pretty strongly by some people about increasing the risk to the FHA fund.

Are there any ways that any of you have to suggest that we can provide those protections and reduce the risk?

Yes.

Mr. GOURLEY. Well, FHA underwriting standards have already been—I think Mr. Butts was complaining about the other side of the coin—that they already have been tightened. This is one thing that has happened over the last year or two as we have had more concerns about the quality of credit, is just using good, sound underwriting standards when you go with the lower downpayment. You have to combine the two.

Senator CRANSTON. May I ask you another question on the problem of people walking away when they don't have a substantial investment? Can you conceive of any way that we could provide that once the downpayment is made that during some specified period, like, for example, the first year, that more of the monthly payment be allocated to principal and less to interest in order to rapidly increase the equity of the buyer?

Mr. GOURLEY. Well, when you have a debt service that includes interest that has to be made, you know, it would take a structuring that would be like an up-front discounting or putting a fund in place that might do that. I don't really know how that particular program would work.

Senator CRANSTON. I don't know how it would work either, but it has been suggested as one way——

Mr. GOURLEY. Well, I don't know how to find the money.

Right.

Senator CRANSTON. Could you give me some thought to that——

Mr. GOURLEY. Yes, we certainly will.

Senator CRANSTON [continuing]. And communicate back to us on that idea?

Yes.

Ms. CINCOTTA. If I understand you right, there are mortgages that can be paid biweekly now. I don't think you can do that on FHA, and it might be that mandatorily—if I understand what you are asking—if people had to make whatever the payment would be, $500 or a $1,000, just split it, that they would be buying down the price of the principal faster on that.

Senator CRANSTON. Yes, at the outset. At the outset.

Ms. CINCOTTA. Well, if you had a 30-year mortgage but you had to pay it biweekly and it was FHA—already some of the conventional lenders are trying it, but I think if it had to be mandated in there, you would be buying down the cost of the house much faster because the principal buys down faster, you would be owning your home faster and less likely to get into trouble, and yet without changing your payments or interest or anything.

So I would think that biweekly mortgage payments is something that hasn't been done and also manufactured housing. I would like to get manufactured housing in Chicago. You can't get them. As well as bimonthly mortgage payments, it hasn't been looked at closely as some way of getting people to have more equity in their home faster, and only a few private institutions are offering it. I know it is a little bit more paper, but that might be one of the bigger answers of getting some equity.

I know we are going to run soon, so I——

Senator CRANSTON. As you know, when you start a loan an overwhelming amount of it goes to interest rather than principal in the early years.

Ms. CINCOTTA. But biweekly cuts down the principal faster. What I have been shown——

Senator CRANSTON. I don't understand that. How does biweekly cut it down?

Ms. CINCOTTA. Because you are buying—you are paying more of the principal faster up front by every 2 weeks. The figures I have been shown, on a 30-year mortgage, is if you paid it, the same amount biweekly instead of monthly you would have the home paid off in at least 12 years.

Am I right on that?

Voices. No.

Mr. GRIBIN. Not that low. I wish you were. I would like to use those statistics.

Ms. CINCOTTA. About 12 years.

Mr. GRIBIN. It is about 21 years. In other words, the mortgage will pay off in 21 years——

Ms. CINCOTTA Well, that is still nice.

Mr. GRIBIN [continuing]. If basically you make one extra monthly payment. In other words, what you do is you make biweekly payments, every other week, and by doing that the mortgage will pay off in 21 years.

Ms. CINCOTTA. But it is more than that even because you are paying on the principal now.

Senator CRANSTON. Just because you are paying on——

Mr. GRIBIN. Yes, you are making basically one extra monthly payment, if you will. You are making 13 monthly payments in a year by making 26.

Senator CRANSTON. It is being hit harder really——

Mr. GRIBIN. And that almost all goes to principal. You can basically do that today merely by making an extra monthly payment on your own mortgage any time you want to, but your idea may make some sense in terms of doing it.

Ms. CINCOTTA. But the principal gets lower.

Senator CRANSTON. Any other comment on the idea that I suggested?

Mr. PEREL. You might use that with ARM's, that some of the savings there would go to pay down the principal instead of just interest savings, and then when rates go up you have also a cushion and you don't have as much to debt service if rates go back up. So you accomplish two purposes.

Senator CRANSTON. The suggestion that more of an increase in the ARM would go to principal?

Mr. PEREL. Well, if you have a savings otherwise of 2 percent on the debt service, rather than all that being for interest savings the buyer would still pay some of that above the base rate, but that extra payment would go for principal paydown, thus building up equity faster and you are protected when interest rates spike back up.

Senator CRANSTON. David.

Mr. BALCER. Mr. Chairman, I was just going to say on the biweekly mortgage, what you are saying is true, but that wouldn't have any substantial effect in the first year. What you are talking about really ends up being an interest subsidy or trying to find ways to do lower interest rates during the beginning term of the loan.

Senator CRANSTON. Yes.

Mr. HODGE. Who pays the interest on the first year? That is the question. Somewhere along the line that has to come before, and I am not so sure that it makes any difference, Senator. If he can't make that payment, whether it is interest or principal, he walks away from it, and if he doesn't walk away from it, he can make the payment.

Senator CRANSTON. Well, you lose more if you have more invested. So there is an incentive to stay if you have a greater equity.

Mr. HODGE. Perhaps.

Mr. LACY. Senator, I think it is also important to have FHA look at where it is incurring its losses. Generalizations are sometimes made, but looking at some of the higher income borrowers versus lower income borrowers combined with 97 percent financing, you will find, I believe, as we found in our statistics, that the lower income people don't default as often as the higher income people because higher income people are leveraging their investment. They are buying the full amount.

So I think a lot more study has to be done, and I don't know if it would mandate a specific change in the program as much as look at where it is being abused.

Senator CRANSTON. Why is it you believe that the low income have less defaults?

Mr. LACY. They buy shelter. If you make more liberal financing available, that means less down, higher-income people will always buy the most they can—higher income people who can afford the monthly payments will buy the fullest house. If things go bad in that market, they have more options available that enable them to walk away.

That happened in Houston, TX and other places.

Senator CRANSTON. Gale.

Ms. CINCOTTA. Not only that, I have always had a conventional loan. I had to show my credit and be responsible forever and if I didn't make my payment they were going to come and get me and make me pay my loan. Under FHA you can quit claim and walk away. Nobody goes after you on any of your resources or anything else, and you can go and buy another home down the block in Denver at half the price because of the bottom falling out of the market and get another FHA mortgage.

I think that FHA is being abused, especially by higher income people in some of these areas who have said I am OK in my home but I will default to buy his home because he lost his job and I can buy his home cheap, and FHA is not going to do anything to me and they'll let me buy another home under FHA. I think that is out and out fraud.

Then on ARM's, ARM's are OK on loans if the interest rates are going down. If the interest rates are going up, it is a killer that increases the foreclosure rate, especially on low-income folks that have to budget how much they can pay every month, every year, and make it.

Senator CRANSTON. Shirley.

Ms. WISEMAN. If I might just comment briefly on that, I have to defend our friends at HUD, having served there 2½ years myself.

There have been changes implemented the past 5 or 6 years where Social Security numbers are required. They are now taking a look at any defaults in the local area. The computer system has been modernized so that they can pull up names, Social Security, and they are going after those folks, and they are monitoring the situation.

They have a credit alert system. They are after it. So in their defense, I believe they are making the necessary changes to keep the program sound, which is what we all want.

Senator CRANSTON. David.

Mr. BALCER. Sir, I had two comments, if I may. One is in going back to your question about the revolving loan fund that we have in Milwaukee that I was just talking about. It is a small program, but we are doing what you are talking about because in loans to housing co-ops on single families residences and duplexes we do lend at about 6 percent interest, and then we set the mortgage up so that it amortizes, say, based on a 9- or 10-percent rate. There is a 5-year term. So there is a very good equity buildup over not only the first year, but the first 5 years. That, though, gets to how do you get combined programs, how do you get to lower interest rates out there?

The other item is completely changing the subject. I just wanted to briefly highlight one comment I had in the National Council's remarks that were submitted to the committee.

Apart from working on our interests in this bill, we wanted to mention that the savings and loan legislation that is coming through Congress proposes the implementation of risk-based capital standards. There is a provision, however, in the Bank Board's risk based capital proposal that in essence gives a disincentive to savings and loans to lend on multifamily housing. In essence, what the proposed regulations do is place them in the highest risk category instead of having the same category as unsecured commercial loans. What we suggest on this is that for multifamily housing where the loan to value ratio is 75 percent or less, that multifamily loans be treated from the same risk standpoint as single family housing. Otherwise, as I say, while you are doing good work, on the other side we are going to be discouraging multifamily lending by savings and loans.

Senator CRANSTON. We are looking at that issue to see if there is something we can do in the conference on that.

Ira.

Mr. GRIBIN. Senator Cranston, I would be remiss if I closed this out without telling you that the National Association of Realtors, that is realtors, and for somebody's information, realtors are not all licensees.

Ms. CINCOTTA. Boy, that's the story we have heard from you all for 20 years.

Mr. GRIBIN. But seriously, you have covered in this bill something that I believe is the national defense of the country. National defense is shelter, food, and clothing, and housing is an integral part of it, and we ought to start concentrating on it, and you and Senator D'Amato are to be complimented.

As I have said for the last 3 years, if we don't do this together, it isn't going to get done. We can disagree on various points, but if we don't get our act together and do what you have done, which is to do something with housing all the way up and down the ladder, then we won't solve the problem, because you can never become a buyer if you haven't been able to get rental property and save enough money from renting so you can afford to buy.

It seems to me your bill covers all of the component parts of the housing ladder, and we will stand by and do anything we possibly can to help you get this bill through in its present form.

Thank you.

Senator CRANSTON. I appreciate that very much, and one thing I do want to solicit is any ideas that any of you have on how we can mobilize greater support for the measure. We have a long process to go through—with this authorization bill first, we have to get appropriations, we have to get it through the budget process, and we have to get it through the tax committees where we don't have jurisdiction here. So there is a long way to go.

I am reasonably confident about completing the task, but any thoughts you have on how we mobilize more support for the rounded program that we will wind up with, we need help on that front.

Mr. GOURLEY. The roundtable is a great format.

Ms. CINCOTTA. Yes.

Senator CRANSTON. I am very glad you think so. I think it is, too. It is much more productive of a clash of ideas and for a better understanding of the different viewpoints.

Have we left anything out? Is there anything you would like to cover that we have not yet covered?

Mr. GRIBIN. Yes, create a greater incentive for apartment construction, do something about the 1986 tax bill, which took away passive income losses, which is 90 percent of the problem because until we do something about that you are not going to get construction. If you don't increase supply, you cannot keep the prices down. You have got to do something about that 1986 tax act which went way too far on passive income.

Ms. BANNON-HARWOOD. We need a secondary market for multifamily.

Ms. CINCOTTA. One of the things we didn't talk about is that while we are talking today about housing. There is in Congress running parallel legislation on the S&L bailout.

I think that for the Congress there would be a missed opportunity, as we spend so much money bailing out the S&L's, to not get them to go back into the housing market and be committed to fund the houses and units we are talking about.

To that end, we would encourage you to look closer at our HOME program where there would be money matched by the Federal Government. You could put that in the savings and loans, build up their savings and then, as the Federal Government matches them, S&L's make the loans for the homes. Also, use the CIF fund. I know my Senator Dixon says $75 million is too much. But we think it should be maybe $200 million a year. The CIF funds would help the S&L's write down the interest rates on these mortgages. With people putting the downpayments is the S&L's it might bring that industry back in housing and deal with part of the problem.

And the other things we didn't talk about were——

Senator CRANSTON. Let me say on that point, I hope that we can find ways to move in that direction. We are not bailing out the savings and loan industry, though.

Ms. CINCOTTA. I understand.

Senator CRANSTON. We are keeping a commitment to depositors.

Ms. CINCOTTA. I understand that, and I don't have a problem with it because that is all our money. But in that process build the S&L's up. Let's put the HOME program in the S&L's and have a large CIF fund.

The other thing we didn't talk about much is revenue bonds. I know it was raised at some point. We have mortgage revenue bonds in the State of Illinois, so we have a homeownership program that is fixed rate, 5 percent down, 8.5 percent financing for new and existing housing. If we didn't have the bonding ability, we wouldn't have that progress in the State. I think that the ability to bond has to be increased for the cities and States.

Senator CRANSTON. Yes.

Mr. LACY. Senator, I would just add one last thing. We need to be aware that the FHA is currently losing a lot of money, and it is just being called to our attention by GAO.

So all I would ask is that we do more for housing and do it right, target it, let's be sure we know fiscally what it is going to cost us, and that issue has been raised here already.

Where are they losing money and why?

Mr. GRIBIN. The MMIF fund, the 203(b) program generally does not lose money.

Mr. LACY. They are losing a million dollars a day.

Ms. WISEMAN. You know, I would question where you get those statistics because that is not correct according to all the reliable reports that I have.

Ms. CINCOTTA. GAO.

Mr. LACY. It is going to get worse.

FHA's losses could double in fiscal year 1989 and triple by fiscal year 1990.

Senator CRANSTON. Any other last words?

[No response.]

Senator CRANSTON. If not, thank you very much for participating and for your help.

We stand adjourned.

[Applause.]

[Whereupon, at 12:34 p.m., the subcommittee was adjourned.]

[Prepared statements of witnesses and additional material for the record follows:]

STATEMENT OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS

Submitted to the

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

on

THE NATIONAL AFFORDABLE HOUSING ACT

June 9, 1989

Mr. Chairman, Senator D'Amato, Members of the Housing Subcommittee:

I am Shirley McVay Wiseman, a homebuilder from Lexington, Kentucky, and President of the National Association of Home Builders (NAHB).

On behalf of the more than 155,000 member firms of NAHB, I am indeed pleased to offer our comments on S. 566, The National Affordable Housing Act. Prior to commenting on the actual legislation, however, I highly commend you, Chairman Cranston and Senator D'Amato, for your commitment and perseverance, as well as that of your totally dedicated professional staff, in drafting this comprehensive housing legislation. We recognize this task has been both time consuming and strenuous, and you have our commitment to work for, and take a lead in, its timely enactment.

I believe no greater challenge faces this great nation of ours than adequate and affordable shelter for all. As a homebuilder for twenty-five years, I have seen major changes in the housing industry. Most have been positive, particularly in the area of mortgage finance, the secondary market and in building technology. During the last six years, alone, we have built ten million new housing units, a remarkable ten percent of this nation's total housing stock.

We have also witnessed several trends that are very alarming, and which have led to such critical consequences that we seriously must ask, "Where will our children live?"

The problem can best be outlined by summarizing from the 1988 study by the Joint Center for Housing Studies, updated in many instances with 1988 figures from the Joint Center's work in progress:

- The homeownership rate in the United States has fallen from a peak of 65.6 percent in 1980 to 63.9 percent in 1988. Had the 1980 rate been maintained, 2 million additional households would have their own homes today.

- The decline in homeownership has been most pronounced among young households. The homeownership rate for households in the 25-29 age group fell from 43.3 percent in 1980 to 36.2 percent in 1988. For households in the 30-34 age group, the rate declined from 61.1 percent to 52.6 percent; and for 35-39 year olds, the rate fell from 70.8 percent to 63.2 percent.

- Although out-of-pocket homeownership costs peaked in 1982, when mortgage rates were at record highs, the after-tax cost of homeownership today still remains well above the levels of the late 1960s and early 1970s. Nationwide, the annual after-tax cost of owning a typical starter home was $7,980 in 1988, 32.8 percent of the average annual income of potential first-time buyers aged 25-29. This was about 50 percent higher than the share of income required in the late 1960s and early 1970s to purchase a comparable home.

- Downpayments continue to be the largest barrier to buying the first home. Using data from the 1986 Consumer Finance Survey, the Joint Center's preliminary findings are that 81 percent of the potential first-time homebuyers (renters age 25-34) do not have sufficient accumulated wealth to make a 20 percent downpayment on a median starter home (assumed $69,154 in 1986).

- While the quality of America's housing stock has improved dramatically over the past 40 years, 4.5 million owners and 5 million renters still live in substandard housing. Inadequate housing is more prevalent in inner cities and outlying rural areas, places with high concentrations of low-income households. One in four young single-parent renter households with children lives in inadequate housing.

- Many markets in America confront a critical shortage of low-cost rental housing, despite rising rental vacancy rates in recent years. While the number of vacant rental units rose from 1.54 million 1981 to 2.66 million in 1988, 90 percent of the increase in vacancies consisted of units renting for more than $300 a month,

well beyond the means of most low-income households. Meanwhile, the total number of units renting for less than $300 a month has fallen sharply.

- An estimated 16 million renter households pay more than 30 percent of their income for rent. Since 1981, gross rents for a representative rental unit have increased 14 percent faster than prices, generally, reaching a median level of $364 in 1987. Inflation-adjusted rents today are at their highest level in two decades.

- The rising rent burden has been particularly onerous for single-parent families, which have seen their rents increase from 34.9 percent of their incomes in 1974 to 58.4 percent in 1987.

- Only 28 percent of renter households with incomes at or below the poverty line live in federally assisted housing units. This suggests that 5.4 million households are left to compete for the dwindling supply of low-cost rental housing available in the private market.

- The shortage of low-cost housing and the rising rent burden, particularly among young, single-parent families, have contributed to the rising incidence of homelessness in the United States.

- The problems of declining homeownership opportunities, shortages of low-cost rental housing, increasing rent burdens and a growing homeless population are all interrelated. Priced out of the ownership market, moderate-income households, that years ago would have been able to purchase a starter home, now are competing with lower-income households for a declining supply of low-cost rental housing. Those at the lowest end of the income scale are seeing their housing options evaporate and, in many cases, are only one financial setback away from being added to the homeless population.

Cutbacks in federal support of housing have contributed to the housing problems we see today:

- Total budget authority for the Department of Housing and Urban Development has been reduced from $37.99 billion in 1978 to $15.41 billion in 1988, while the overall federal budget has more than doubled over this timeframe.

- Housing's share of the federal budget has diminished, with HUD budget authority representing 7.4 percent in 1978 but only 1.3 percent in 1988.

- Numerous housing related programs have been greatly reduced or eliminated entirely, including the Section 8 programs for new construction and substantial rehabilitation, the Urban Development Action Grants (UDAG) and the Housing Development Grants (HODAG). In addition, general revenue sharing, which often provided federal funding for infrastructure activities, has been eliminated.

Mr. Chairman, we cannot overemphasize the Joint Center findings that the problems of declining homeownership opportunities, the shortages of low-cost rental housing, increasing rent burdens and the growing population of homeless are all interrelated. This is the reason why The National Affordable Housing Act must remain intact in its focus on expanded opportunities for homeowners and renters alike; why affordability is a serious issue in urban and rural areas; why new construction and preservation are jointly linked; why direct federal assistance and tax credits cannot exist in a vacuum; and why the federal role in combination with state and local capacities must be in harmony.

We firmly believe that all programs under this legislation should be viewed in light of the following guiding principles.

First, programs must be clear and simple. The administrative complexities of implementing the programs should not distract from the program content nor confuse the public. If debate shifts from programs to their administration, victory will be lost.

Second, the focus has to be private-sector oriented. New ideas must mobilize the resources and imagination of the private sector. Unfortunately, while the "moratorium" on prepayment of privately-owned, publicly-assisted projects has accomplished the goal of allowing for more objective debate over long-term solutions, it has had a very chilling effect on many who desire to provide affordable rental housing for low- and moderate-income individuals in the future. The capacity of the private marketplace must be tapped in order to have a widespread, significant impact on the problem.

Third, providing and maintaining the infrastructure needed for safe and quality living conditions must be considered as part and parcel of meeting housing needs. Affordable housing cannot be provided if the infrastructure is not in place or if its cost must be imposed "up-front" on each new housing unit.

Fourth, the tax treatment of all housing, both owned and rented, single-family and multi-family is crucial. The home mortgage interest deduction has long been the cornerstone of American housing policy. Any further restrictions on it would

have pervasive effects on the quality and affordability of our nation's housing, as well as our attitudes toward homeownership.

Fifth, the long-term health of the economy is clearly vital. The demand for dollars to finance the federal deficit continues to plague the credit markets in ways which impact directly on housing affordability.

Finally, Congress should exercise caution in any restructuring of the Executive branch. While we welcome attention toward strengthening HUD's role, reorganizations are time consuming and deflect attention away from program implementation.

I will now discuss the various topics covered by the National Affordable Housing Act: Homeownership, HOME Corporation, Homelessness, Low-Income Housing Preservation, Special Needs and Supportive Housing, Rental Assistance and Rural Housing.

HOMEOWNERSHIP

The decline in the homeownership rate reflects many factors. The most influential single factor has been high "real" interest rates. In previous periods when inflation has been below four percent, home mortgage rates for fixed rate loans have been below eight percent. Even though nominal interest rates have declined over the past seven years, real interest rates are still quite high by historical standards. Further interest rate reductions will depend to a large extent on serious, long-term efforts to cut the federal deficit, and that must remain a top priority.

High monthly mortgage payments, due to high interest rates and high home prices, have been a strong deterrent to homeownership for young families. Increased downpayment requirements have also become a serious obstacle. Increased up-front costs, increased home prices, restrictions on the FHA and VA programs, and changes in mortgage underwriting standards have all contributed to the downpayment problem. The FHA mortgage insurance and VA loan guarantee programs historically have played a key role in making homeownership affordable to many American families. These programs lower both interest costs and the amount of cash that buyers must produce at the time of home purchase. These vital programs have not only served critical needs directly, but in the past have been a source of innovations that later were adopted in the conventional mortgage market.

In recent years, however, there have been a series of proposals aimed at restricting the FHA and VA programs. While

Congress has rejected most of those proposals to date, we feel it is important to reiterate several important points.

- The primary FHA insurance program is a self-supporting mutual insurance arrangement in which premiums paid by relatively low-risk borrowers help provide the funds to insure against defaults by higher-risk borrowers. Proposals to further restrict eligibility, such as setting income restrictions, would endanger the actuarial soundness of the insurance program. Furthermore, the credit ceilings of FHA and the GNMA mortgage-backed securities program should not be reduced in the event of across-the-board cuts in the budget to meet Gramm-Rudman-Hollings deficit targets. Cuts in these program activity levels do not contribute to deficit reduction, and they should be exempted from the sequestrable categories.

- The development of alternative mortgage instruments, particularly adjustable rate mortgage (ARM) loans, has played an important role in keeping housing credit available and affordable during periods of high and volatile interest rates. Restrictions on the terms and availability of adjustable-rate FHA-insured mortgages, and the absence of adjustable-rate VA-guaranteed loans, have detracted from the value of those programs. These restrictions are in stark contrast with the history of FHA and VA, which have traditionally been leaders in innovative techniques.

The difficulty young households have in becoming homeowners is not only a source of frustration for these young people, but also a loss to society as a whole because homeownership is fundamental to neighborhood stability, community participation, capital accumulation and good citizenship. Indeed, it is appropriate that facilitation and encouragement of homeownership be recognized explicitly as a national housing goal in any housing legislation produced by this subcommittee.

Recommendations

Despite the provision contained in the Housing and Community Development Act of 1987, to increase the maximum mortgage amount for FHA loans in high-cost areas, the FHA loan limits are not high enough to finance purchase of a median-price home in many areas. This is true particularly in California and New York. Instead of imposing a nationwide cap on FHA insured loans, the maximum loan amount in each area should be based simply on 95 percent of the median home price in that area. This would provide more equitable access to FHA financing for our citizens. NAHB strongly supports this provision in the National Affordable Housing Act.

Adjusting the maximum mortgage limit to provide equal access to all families, regardless of geographic location, is both equitable and safe. Past FHA performance suggests that the upper portion of the value distribution is far less default prone, thereby serving to enhance the fiscal soundness of the insurance fund. Put another way, denying equal access places the health of the fund at greater risk.

Communities where 95 percent of median would fall below the current maximum mortgage limit of $67,500 should not be penalized. At a minimum, these areas should be grandfathered. Federal Home Loan Bank Board data reflects that at least 17 percent of the places surveyed would otherwise experience a decrease in the maximum mortgage limit. The FHA ceiling has not been raised since 1979. Adjusting for general price inflation alone, would raise the basic ceiling to $96,900. Adjusting for home price inflation would raise the basic ceiling to $108,200. Such an adjustment, however, still would not address the inequity of a national ceiling in high cost areas.

The FHA insurance and VA guarantee programs represent only one element of federal support for the housing finance system. The Farmers Home Administration provides low-rate financing for low- and moderate-income housing in areas that are not adequately served by private lenders; this program has successfully contributed to the realization of the American Dream and ought to be preserved. In addition, federally related enterprises which operate in the secondary mortgage market, along with a system of federally insured thrift institutions committed to housing finance, have ensured the availability of mortgage finance for homebuyers at reasonable rates.

The Government National Mortgage Association (GNMA) should continue to guarantee mortgage-backed securities that facilitate the flow of capital from the financial markets to homebuyers using federally insured mortgages. GNMA should also experiment with innovations in mortgage securities and participate in new approaches to financing rental housing. The Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association should continue to provide secondary markets for mortgage loans and to act as innovators in the development of new mortgage instruments and mortgage-backed securities involving conventional loans. In addition, these entities should stress their traditional leadership role in providing affordable housing credit through the purchase of home loans with low downpayments and reasonable underwriting standards.

Tax-exempt state and local mortgage revenue bonds (MRBs) have provided low-cost funds for home mortgage loans for moderate-income first-time homebuyers who would otherwise have found it difficult or impossible to buy homes. Tax-exempt bond authority for MRBs should be extended before the December 31,

1989 sunset date. Consideration also should be given to setting separate MRB volume limits based on housing demand, rather than placing MRBs under a cap based on state population. Furthermore, there should be no requirement that the MRB "subsidy" be recaptured when a home is sold.

To address the downpayment problem, it is necessary to reduce not only the up-front cost of buying a home but also to facilitate the accumulation of the necessary amount of funds by prospective homebuyers. Several low-cost measures could help to achieve those objectives, and we commend you for incorporating them in The National Affordable Housing Act.

Home purchasers should be permitted to invest funds from their Individual Retirement Accounts (IRAs) and 401(k) retirement plans in their homes as downpayments. These investments should not be considered "withdrawals" from those funds, but simply alternatives to investment in CD's, mutual funds, or other vehicles now classified as eligible investments. Additionally, we believe the Subcommittee should give serious consideration to providing equal treatment for those who are self-employed and have established a Keogh retirement account.

Since 1974, the minimum downpayment for FHA loans on homes valued in excess of $50,000 has been three percent on the first $25,000 and five percent on additional amounts. Median new home prices are now approximately three times as high as they were in 1974. In light of the higher levels of home prices today, the portion eligible for the three percent downpayment should be raised to at least $50,000, and first-time homebuyers should be allowed to apply for FHA mortgage insurance using a flat three percent downpayment.

On the issue of requiring pre-purchase counseling of first-time homebuyers, as required in the legislation of those who go with a simple three percent of the mortgage amount, we would respectively urge against broadening this requirement to include other purchasers as well. We are concerned that any massive increase in the numbers required to obtain counselling, or any lengthy counselling format, could easily lead to a breakdown in the system of timely closing of mortgage loans. This by itself could have a negative impact on affordability in a rapidly fluctuating market and serve as a detriment to those the Subcommittee seeks to serve.

The specific proposal for investment of retirement savings in home purchases includes a restriction that retirement funds be invested in a home with a sales price of no greater than 110 percent of the area median price. We strongly urge that this restriction be eliminated. Households contributing funds into their account over a period of years must be confident that these funds can be applied to the home they choose. Because of

changing lifestyles, needs, relocation to other geographic areas, access to the workplace, or deficiencies in home price data, savers may not find an acceptable home within the price limit. With this restriction, many young households would not be willing to risk contributing funds that might, in effect, become unavailable for the downpayment.

Elimination of the house price limit would not mean that higher income households would be the primary beneficiaries of the plan. There are at least two other limitations which provide better limits than the home purchase price limit. Existing restrictions on deductible contributions to IRA's, together with the proposed restriction on the maximum investment of retirement funds in home purchases, provide a limit to the use of the benefit. Moreover, higher income individuals would find it more advantageous to invest tax-sheltered retirement funds in normally taxable financial instruments and to use other, non-sheltered funds for downpayment to purchase a home.

The section modifying existing legislation with respect to Adjustable Rate Mortgages (ARMs) is too weak and lacks the necessary inducement to guarantee that HUD liberalizes the ARM program. In contrast, the disclosure statement requirements are overly specific and are more properly the subject of regulations. To meet these concerns, we suggest the following language: "The Secretary shall insure adjustable rate mortgages that incorporate terms and conditions that the Secretary finds to be generally accepted in the mortgage market. The Secretary shall determine insurance premiums that sufficiently cover the expected risk of loss."

ARMs are especially adaptable to the needs of first-time homebuyers, whose current incomes may not qualify them for fixed-rate mortgages, but whose incomes can be logically expected to increase as a result of increased work experience.

The FHA-ARM has been a less than successful instrument under the current legislative restrictions, and we encourage HUD to promote a viable ARM program.

With respect to the broad authority granted to the Secretary for demonstration programs, we support providing HUD increased program flexibility in this area. However, we believe the direction provided them, "... the type of mortgage (that) has achieved general acceptance in the private mortgage market," is a redirection from its long-held position as an innovator, demonstrating to the rest of the mortgage industry the viability of new programs to meet the needs of an ever changing market. To duplicate an instrument developed in the private market for the sake of demonstration would not be a role we believe appropriate for FHA. Rather, we believe a better use of resources would be to further its role as innovator and explore such instruments as

the Accumulating Mortgage Downpayment Demonstration program and the Downpayment Second Mortgage Demonstration program contained in S. 197, Homeownership Assistance Act of 1989, cosponsored by Senators Sasser (D-TN) and Heinz (R-PA).

HOME CORPORATION AND HOP GRANTS

NAHB supports the concepts intrinsic to the HOME corporation and the HOP grants. A flexible housing grant program provides government entities with the ability to design programs for their particular situation and budget. We strongly support the concepts of local choice across a broad range of housing assistance vehicles. We urge the committee and the Congress to reach quick and adequate funding for the HOP grants.

Recommendations

Some specific adjustments are called for in the bill as currently proposed. While we encourage the entitlement concept that allows governments to share equitably in this program and plan adequately for future needs, we believe the incentive portion of the bill creates a needed focus on leveraged funds, on innovative approaches and on communities with especially successful programs. Consequently, a reallocation of the split between entitlement and incentive awards is needed. We proposed 70 percent of the HOP funds go to entitlement and 30 percent go to incentive grants to provide greater encouragement of leveraged funds and innovative ideas.

A second adjustment must add to the entitlement formula a measurement of local regulatory control. HUD and NAHB cooperated in the Joint Venture on Affordable Housing to reduce the cost of local restrictions on housing. That experiment demonstrated an average $8,573 per unit cost reduction could be accomplished through a combined strategy of regulatory relaxation, higher densities, less restrictive development requirements and building code updating. Costs savings of this magnitude and more can be accomplished if the entitlement formula includes as a condition, a state and community effort towards reducing burdensome and unnecessary regulations, towards more flexible zoning for affordable housing and towards expedited development review processing.

HOMELESSNESS

Mr. Chairman, We commend you and this Subcommittee for its interest in overcoming one of America's most unfortunate tragedies, that of homelessness.

Regardless of whether the actual number of homeless in this country is three hundred thousand or three million, the fact remains it is a national tragedy. The numbers represent real people with real lives who face real problems. They are represented by children, adults -- both young and old, single parents, entire families -- both the unemployed and the employed, those who suffer from abuse -- whether imposed by others or self-inflicted, and the disabled -- whether physically or mentally impaired. In short, the homeless population is somewhat reflective of the population at large, perhaps not in the same proportion, but representative nonetheless.

An entire menu of causes contributes to the homeless population, but clearly the lack of available, affordable shelter is among the most vital, and one cause that we, as providers of housing, and the Subcommittee, as authorizers of housing legislation, can seek to overcome together.

The reauthorization of the Stewart B. McKinney Homeless Assistance Act was a commendable beginning. The law reflects the clear need for a federal role to address this issue. It reflects the need to develop and implement public-private partnerships to address the many facets of homelessness. It complements the need, through its varied approaches to address the problem, for good old-fashioned private sector initiatives.

Recently, the Conference of Mayors reported that the number of homeless continues to grow and that families with children now compose perhaps as many as one-third of this group. Included among the homeless are many who have jobs. And, as we have seen in press reports within the last several months, a large number of school-age homeless children are at great risk of not only a lack of proper shelter but also the lack of a full and complete education. This country's housing problem extends beyond the homeless.

When young adults, families, and the elderly are denied an opportunity to move to meet their changing needs, everyone suffers. Unfortunately, often it is those on the bottom rung of the economic ladder who suffer most. The lack of affordable rental housing for low- and moderate-income Americans, as well as the lack of opportunity for first-time homebuyers, has placed inordinate pressure on the system. One of the tragic results leads to families facing homelessness.

The market has been squeezed by various factors, among which are a lack of tax incentives to produce low-income rental housing, fewer incentives to retain the existing low-income housing stock and an increase in regulatory roadblocks for both single-family and multifamily housing, including rent control, inordinate impact fees and slow growth and no growth policies. The results are not surprising.

Recommendations

The need for continued federal leadership in overcoming the plight of the homeless, and the issue of providing permanent housing targeted not just for those at 80 percent, or even 50 percent of median income and below, but targeted specifically to the homeless population deserves serious consideration. As a nation, we must take the extra effort to ensure that entire segments of the population are not left behind because we choose to ignore them.

We support the use of Section 8 assistance for single room occupancy units as provided in this legislation. Further, Mr. Chairman, we respectfully urge the Subcommittee to allow for the application of FHA mortgage insurance for limited construction of new single room occupancy structures to further address the needs of homeless individuals.

While we do not advocate the development of single room occupancy projects as an ideal form of living, it can be a vast improvement to having no home at all or overcrowding in existing low-income housing to the extent that this latter housing becomes unsafe and unsanitary for all.

PRESERVATION

Mr. Chairman, we offer our assistance and continued support of your efforts to properly address the critical issue of preserving the privately-owned, publicly-assisted low- and moderate-income rental housing stock.

As we have testified previously before this Subcommittee, every reasonable effort must be made to preserve the existing housing stock while retaining an atmosphere conducive to future development of multifamily housing for low- and moderate-income families.

To encourage future development, the federal government must not abandon its contractual obligation to allow owners to prepay the existing mortgage. Neither should the government abandon its support to low-income families in need of housing assistance, nor should it expose the Federal Housing Administration to increased risk of default on the part of a project owner. We believe these goals are not in opposition to each other, but can and should be jointly considered in developing preservation legislation.

NAHB supports the following principles articulated in the National Housing Preservation Task Force report of February 1988, "Preservation of Low- and Moderate-Income Housing in the United States of America:"

- Owners have a clear contractual right to prepay and to use the property for other purposes unless prohibited by other federal contracts, such as rent supplements and flexible subsidies.

- Low- and moderate-income tenants residing in projects, whose owners elect to prepay, should be provided affordable shelter of at least comparable quality and cost.

- Tenants affected by prepayment should be permitted to remain in place, with no increase in rent to the tenant except for regulatory considerations, until adequate replacement housing is made available.

- The federal government is responsible for providing necessary tenant-based rental assistance and to ensure that sufficient low- and moderate-income housing continues to be available to meet a community's needs.

Recommendations

The challenge facing us all is to develop a set of financial incentives that will result in most owners choosing to agree voluntarily to maintain low- and moderate-income housing projects for families of low- and moderate-income, without overly committing scarce federal resources. To this end, NAHB supports the following objectives:

- Section 8 project-based contracts should be extended, at the option of the project owner, for a period equal to the use restrictions, with commensurate appropriations to provide funding for these contracts.

- The Department of Housing and Urban Development should expeditiously implement those incentives contained in the Housing and Community Development Act of 1987, in particular the authority to increase rents, for rental subsidies and for equity take-out through second mortgage loans. Incentives should also be provided by Congress, such as restarting depreciation based on the current appraised value of the property or allowing other appropriate incentives to encourage owners to maintain the low-income housing stock.

- Where a project subject to use restrictions is sold to a qualified non-profit entity for the outstanding mortgage balance, the transfer should be a non-taxable event for the seller. Or, if a project is sold to a qualified limited dividend entity, and the entity enters into an agreement to maintain the project for low-income use for

the balance of the term of the mortgage, the tax liability to the seller should be phased-in over a five year period.

We recognize that only the financial incentives are within the jurisdiction of the Committee on Banking, Housing and Urban Affairs, while the tax incentives are within the jurisdiction of the Committee on Finance. However, both are needed if we are to obtain the goal of preserving, to the maximum extent practicable, the existing low- and moderate-income housing stock.

It is because of the multi-jurisdictional nature of this critically important area of housing preservation that this Subcommittee should seriously consider incorporating the tax and housing policy coordinating council provision of the Housing Grant Action Program Act, S. 853, sponsored by Senator Dodd (D-CT). NAHB strongly supports better coordination of housing and tax policy, particularly as it relates to the federal role in preserving our nation's existing housing stock.

SPECIAL NEEDS AND SUPPORTIVE HOUSING

NAHB supports the Subcommittee's leadership in advancing the issue of supportive housing to Assistant Secretary level status to administer those programs at HUD that exclusively serve the elderly, handicapped, homeless persons, or others with special needs requiring supportive services relating to the housing.

We are also supportive of the Section 512, Project Retrofit, to provide assistance to retrofitting public and common use areas, as well as individual dwelling units in federally assisted elderly housing, to allow the frail elderly to live with dignity and independence. Retrofitting should not become a mandatory requirement, however, of existing projects in order to continue federal assistance. Moreover, we support the wisdom of the Subcommittee in avoiding the establishment of set asides for fully adaptable housing.

Recommendations

Deletion of existing law provisions that allow for Section 202 elderly housing to be developed by limited dividend sponsors, consumer cooperatives and public entities to, in effect, allow development by only non-profit sponsorship appears to us to unnecessarily restrict the development of this much needed housing. While recognizing that limitations are often placed on the development of such housing by appropriations for the authorization which result in a similar impact, we believe that limited dividend sponsorship should not be disqualified totally.

We would welcome, however, the deletion of the provision to continue Davis Bacon prevailing wages on all such projects designed for twelve or more persons by the Subcommittee as an excellent target of opportunity in an effort to make the difficult choices necessary to ensure more affordable housing. The history of the impact on artificially established wage rates on a community and the resulting project are well documented.

RENTAL ASSISTANCE

In the area of rental credits, we commend you for taking the logical, but not necessarily easy step of combining the Section 8 existing certificates and vouchers into rental credits. We welcome your decision to combine the most desirable features of each, while providing states and localities some flexibility in their use.

These rental credits, however, will be for a term of five years, whether they are used as "voucher-type" non-project-based assistance, or whether they are used as project-based subsidies to renew expiring Section 8 contracts or to provide incentives for new construction or rehabilitation. If the federal commitment on project-based assistance is for only five years, lenders and investors will be unwilling to make long-term financial commitments. In the case of expiring federal or private commitments to the existing assisted stock, a short-term commitment of federal assistance will not be adequate to achieve the objective of extending "to the maximum extent practicable, the low-income affordability of housing that has been produced with federal assistance." The expiring Section 8 existing contracts are likely to be a greater problem than the prepayment issue. In order for project-based rental credits to stimulate effectively the retention and the expansion of the supply of low-income affordable rental housing, longer-term commitments must be available.

Recommendation

We confess we do not have the answer on how to balance the budgetary impact with the need for a longer-term assisted contract in order to achieve the needed result. But we believe a solution must be found if we are to achieve the additional housing that is, and will continue to be needed to house low- and moderate-income families over the decade ahead.

RURAL HOUSING LEGISLATION

We applaud the Subcommittee's reaffirmation of support for rural housing programs as administered by the Farmers Home

Administration (FmHA) at the Department of Agriculture. These programs have provided low-income families and the elderly with affordable housing since the inception of this legislation in the 1949 Housing Act.

On the proper treatment of the prepayment of Section 515 rural rental housing loans, we are concerned with overly restrictive prepayment proposals. We also would like to express our reservations on the provision in S. 566 that defers a portion of the principal under the Section 502 deferred loan program. While we appreciate your commitment to underserved areas, we question the creation of project preparation advances, that are limited to administrative needs without producing any new units of housing. We are pleased that you have added a provision to allow private sector builders to participate in the Section 502 conversion program, that is currently limited to non-profit organizations. We also urge you to designate a specific set aside for rural areas under the Home Corporation and the Housing Opportunity Partnership Program (HOP).

Recommendations

Rural Housing Authorizations

Mr. Chairman, we urge the Subcommittee not only to extend rural housing programs for two years as authorized in S. 566, but also to make the authorization permanent. This was done for FHA in the 1987 Housing Act. The Section 515 multifamily program, like FHA, was stopped several times in 1986-87 because Congress did not pass reauthorizing legislation on a timely basis. There is great demand for rural programs, where 55 percent of the assistance goes to families making less than 50 percent of area median income.

Section 502 Conversion to Section 515

We are very pleased that a provision to allow developers to convert Section 502 single-family housing inventory properties to Section 515 rental housing is included in to S. 566. Currently, the Housing Act restricts conversions to non-profit organizations and public bodies. This legislation could save Farmers Home $40 million a year in maintenance and interest costs if all the 10,400 units were taken out of inventory. Since 1983, only four conversion projects in three states have been completed.

Section 502 Deferred Loan Program

NAHB is concerned with the section creating a deferred loan program under the Section 502 single-family program. A deferred

loan program, which allows a buyer to defer principal on the loan, as well as interest, could add greatly to the cost of the program at a time of tight budget priorities. Higher subsidy costs and negative amortization would likely occur under this program. Even though the deferment is limited to 20 percent of the loan principal, negative amortization would still occur.

Additionally, future problems may arise due to increased loan delinquencies and foreclosures. This program tries to include people who were not able to qualify for a loan even with a subsidized interest rate of one percent. They may not be in the threshold of affordability and would have difficulty in meeting the maintenance costs, utilities and other expenses of homeownership. The Section 515 rental program may be a better way to provide for these households, where housing costs are less and maintenance and repairs are provided.

Section 502 Moderate Income Loan Guaranty Program

As you are aware, the 1987 Housing Act includes provision for a four year moderate income loan guaranty demonstration program under Section 502. Similar to your proposal for a deferred loan program, the funding is to come from unused allocations to the states.

We urge you to make the Section 502 loan demonstration program permanent along the lines of H.R. 2388 introduced last month in the House. The provisions of The Rural Housing Improvements Act of 1989 state that income cannot exceed 100 percent of median and the mortgage amount cannot exceed the FHA limits of $67,500 - $101,250. Loans are guaranteed by FmHA in areas not adequately served by other mortgage lending institutions. It also expands the Federal Agriculture Mortgage Corporation to create a permanent, less costly flow of mortgage credit.

While interim regulations have been issued by FmHA for the loan demonstration program passed in the 1987 Act, funding still needs to be provided to make it operational. We see a loan guarantee program as a viable addition to providing alternative credit sources.

Housing in Underserved Areas

S. 566 stresses the need for outreach to underserved areas that have a high level of poverty and substandard housing. It sets aside one percent and two percent of funding in FY '90 and FY '91, respectively, for this need including Section 502, 504 and 515. The Secretary of Agriculture is to designate 30 counties in FY '90 and 50 counties in FY '91 as underserved

areas. This section of the legislation also makes provision for project preparation advances. An area is eligible if over the past 10 years it has received substantially less assistance than other areas in the state calculated on a per capita basis. An area must also have at least 20 percent of its population below the poverty line and ten percent in substandard housing.

NAHB realizes the need to serve low-income people in hard to reach areas and would be supportive of a small set aside on a trial basis. We have reservations, however, because we believe that better utilization of rural programs is made when geographic designations are not made. It should also be pointed out that the FmHA may already have authority to make loans in underserved areas, if population restrictions and income qualifying provisions are met.

We recommend, however, that any unused funds set aside for this program be returned to the rural housing insurance fund after nine months. The September 1 date in the legislation, which releases money to be spent in another targeted area, would likely result in funds not being spent at all. The Farmers Home Administration receives many more applications for funding than it is able to fulfill and this would enable unused money to be spent by the end of the fiscal year for needy families under current programs.

Project Preparation Advances

We have reservations with project preparation advances that can be incurred for up to 80 percent of the costs of preparation of preapplication for a loan under many FmHA programs.

First, we are concerned that too much emphasis is being placed on administration rather than on the actual construction of housing.

Second, project preparation advances are limited to community organizations and non-profit corporations near eligible communities. We urge you to include private sector builders and developers in the program. Almost 90 percent of the housing built under FmHA is constructed by private builders and developers. We feel that a level playing field for limited profit and non-profit developers and builders needs to be adopted when making decisions on the best way to deliver low cost housing to rural areas. Any legislative priority given to non-profit organizations should not be given without full consideration and examination of the economic viability and operation of non-profit projects. By making limited profit builders eligible, not only for this program, but others now restricted to non-profits, we feel that housing will be constructed in a more efficient manner at less cost.

HOME/HOP/Rural Set Aside

It is important that a rural set aside be made under any urban development program created by HUD. This would include making rural areas eligible to receive assistance through the HOME Corporation and the Housing Opportunity Partnership (HOP) program. The HOME corporation which acts as a secondary market entity and the HOP program, which is similar to a grant, could be of assistance in rural, as well as urban areas. A proportional share should be set aside for rural areas to adequately house low-income people in small communities. If feasible, this program should be carried out through the Farmers Home delivery system which has over 2,000 state and local offices across the United States. When you have offices nearby with qualified personnel and a good state director, the FmHA delivery system works well.

Section 515 Prepayment

NAHB testified on May 18, before the House Housing Subcommittee on a panel concerning Section 515 prepayment. (H.R. 1180). This legislation includes a restriction on prepayment or refinancing of newly financed Section 515 loans for up to 50 years. NAHB took issue with such a lengthy prepayment prohibition on new loans and suggested that consideration be given to tying changes on prepayment with changes being proposed to the low-income housing tax credit. We also stated that there would be no residual value left in the property after 50 years, which is one of the reasons a developer goes into the project in the first place. Allowing a builder to resyndicate once the original tax benefits run out and liberalizing depreciation rules for low-income housing would be incentives to keep investors interested in investing in low-income housing projects.

Another problem with retaining investors in low-income projects concerns "phantom income." The amount of income an investor has to report each year, after the first several years of the investment, is greater than the amount of income actually distributed to each investor because FmHA limits the amount of income distributed to each partner. Since a partner must pay tax on partnership income whether or not distributed, an individual may have to pay tax on income he does not actually receive.

It must be noted that very few Section 515 projects have been sold or prepaid. Also, few equity take outs have been provided. Many states have not had any activity.

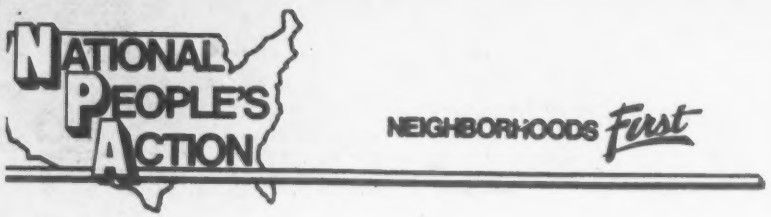
CONCLUSION

In conclusion, it has become increasingly clear that the challenges of today and the decade ahead can be met only by reinvigorating our national commitment to housing. It is also clear that housing production is dependent on a healthy economy and reasonable interest rates. Accordingly, the impact of these proposals must be weighed in light of additional burdens on the federal deficit.

As the housing community proved so recently with the enactment of the Housing and Community Development Act of 1987, it is only through the combined effort and support by all that we are able to bring this goal to reality. Competing efforts and demands on the federal treasury and the political and economic agenda are real.

To restore housing to its proper place as a top national priority, and thereby ensuring that housing truly will be the American promise, will require a dedicated effort by all. We stand ready to meet this challenge with enthusiasm, Mr. Chairman. We will continue to provide the Subcommittee with additional technical recommendations or various provisions. We look forward to continuing this open dialogue with the Housing Subcommittee.

22-940 O - 90 - 3



TESTIMONY OF

GALE CINCOTTA,

CHAIRPERSON,

NATIONAL PEOPLES ACTION

BEFORE THE

SENATE SUBCOMMITTEE ON

HOUSING AND URBAN AFFAIRS

JUNE 9, 1989

Mr. Chairman and Members of the Subcommittee on Housing and Urban Affairs, thank you for this opportunity to testify before you today. My name is Gale Cincotta, and I am Chairperson of National People's Action, a national coalition of grassroots community groups.

You have asked me to testify on our country's homeownership affordability problems and on the National Affordable Housing Act. Title II of the Act proposes to liberalize FHA-insured mortgages by:

- lowering FHA downpayments to three percent of total home value for first-time homebuyers,
- expanding FHA mortgage ceilings to 95 % of area median sales price, and
- authorizing more widespread use of adjustable-rate mortgages (ARMs) under the FHA program.

It is almost precisely 12 years since I testified during hearings of the Senate Banking Committee on "The Future of FHA." Those hearings were held by Senator Proxmire in the wake of widespread scandals that resulted in catastrophic FHA foreclosure rates in inner cities. Ironically, many of the steps proposed in the National Affordable Housing Act would bring us full circle, back to a period when an overly liberalized FHA actually caused inner-city deterioration. America has a very serious homeownership affordability problem. Expansion and liberalization of FHA will not solve these problems. Instead, it will make our nation's housing problems worse.

To explain my views, let me first present some background information in two areas: the nature of our housing affordability problems, and the existing areas of weakness within the FHA Mutual Mortgage Insurance Fund.

America's Housing Affordability Gap

Much has been made of the decline in homeownership levels among American households. However, there has been relatively modest change in overall homeownership levels in the past decades. The Joint Center for Housing Studies at Harvard reports that homeownership rates increased from 64.4 percent of all households in 1973 to 65.6 percent in 1980, and then declined to 64 percent of all households in 1987.

However, these numbers disguise a significant shift in homeownership levels among different segments of the American population. Simply put, the rich have gotten house richer, while the poor have gotten house poorer. The Harvard study shows that between 1974 and 1987, using constant 1986 dollars, homeownership

rates increased for families making above $35,000 but decreased for families making below $35,000.

The 13th Annual Survey of Recent Home Buyers published by Chicago Title and Trust confirms that the constant dollar income level needed to become a homeowner is spiralling upward. In 1985, the Survey states, three in five first-time buyers had incomes below $40,000. By 1988, only two in five first-time buyers made less than $40,000. By contrast, the percentage of first-time buyers making $40,000 to $60,000 increased from 32 percent in 1985 to 38 percent in 1988.

The Chicago Title Survey shows why moderate-income families are being hurt the most. First, let's review what has not changed. Downpayment levels today are about the same as those of a decade ago. The average first-time buyer put 18 percent down in 1976, 20 percent down in 1987, and 15 percent down in 1988. The average amount of time spent accumulating a downpayment was the same in 1988 as it was in 1976: precisely 2.4 years.

Two housing affordability factors did change dramatically: home price and monthly housing costs. Between 1976 and 1988, the median price of a starter home soared from $37,670 to $97,100. Average monthly payments on first homes tripled, from $313 in 1976 to $929 in 1988. As a result, first-time buyers had to spend a higher percentage of income on mortgages than ever before: 35 percent of income in 1988, compared to only 23 percent in 1976. Consequently, it takes constantly higher incomes to afford homes. The median income of first-time buyers rose from just over $20,000 in 1976 to almost $50,000 in 1988.

So the National Affordable Housing Act is pointing to a real problem that touches even relatively affluent families. However, it misses this point: Low downpayments do not make expensive homes more affordable. They actually make homes less affordable. Especially in high-cost cities, buyers needed large downpayments to cross the affordability threshold. In New York, for example, the median-priced starter home cost a whopping $180,000 in 1988. The typical first-time buyer made a 22 percent downpayment saved over three years, and still paid 46 percent of their income on housing. In lower cost cities, buyers could afford to buy homes with smaller downpayments. In Memphis, for example, the average first-time home cost only $61,000. The average first-time buyer spent only 29 percent of income on housing, and made only a ten percent downpayment saved in an average of two years.

I commend the Chairman of this Subcommittee for taking the lead in addressing a homeownership affordability problem that for too long had been ignored. In addressing that problem, here's the central facts to keep in mind:

- Most families being priced out of homeownership make less than $40,000 a year.
- Downpayment is not a barrier to affordability for most of these families, because:
  - typical first-time buyers can still save a downpayment of ten to twenty percent in two to three years;
  - buyers making under $40,000 would be purchasing homes that already qualify for low FHA downpayments.
- The greatest impediment to homeownership is excessive monthly housing costs. In 1976, average costs for first-time buyers required less than one-quarter of their income. Last year, they required more than one-third of buyer income.
- In high-cost cities, the typical strategy used by first-time buyers is to save larger downpayments. These downpayments are necessary to lower monthly mortgage costs to barely affordable levels.

Weaknesses In FHA Financing

By design, FHA is a program for households at the margin of eligibility. That explains why FHA delinquency and default rates are persistently twice as high as those for conventional loans. For example, as of the fourth quarter of 1988, the MBA reported that 6.55 % of FHA loans were delinquent nationwide, compared to 3.06 % of conventional loans. FHA loans with three percent downpayments are a vital part of federal housing policy, but they clearly entail higher risk for those that use them.

At its best, FHA has pioneered loan instruments that have transformed the mortgage lending market and increased homeownership affordability. For example, FHA confirmed the soundness of the long-term, fixed-rate mortgage, using insurance on this instrument to turn a profit every year.

At its worst, FHA crossed the boundary of acceptable risk and discredited loan markets that were actually sound. In the 1960's and 1970's, FHA offered overly liberalized underwriting for inner-city areas that, often in combination with abuse by realtors or mortgage bankers, resulted in catastrophically high foreclosure rates.

In recent years, concerns about FHA's lending practices have been mounting for a number of good reasons.

In fiscal year 1988, FHA had a net loss of $368 million. FHA was forced to redeem $643 million in excess funds invested in Treasury securities, further increasing federal deficit problems.

As a result of mounting losses, FHA capital has been reduced

to an estimated $2.8 billion, resulting in a capital to risk level well below that required of private mortgage insurers.

FHA's inventory of foreclosed, vacant homes last year approached the 90,000 mark, rivaling the levels created during FHA foreclosure scandals of the previous decade. The inventory was reduced to 46,000 by October of 1988, but only through a fire-sale disposition process that shattered housing values in energy-driven markets such as Denver.

The high foreclosure rates that have plagued FHA undercut its basic purpose: providing affordable yet sound homeownership opportunities. By the end of 1987, for example, about one in six FHA loans made in 1981 had resulted in a default, according to the Actuarial Branch of the Department of Housing and Urban Development. 18 percent of homebuyers making five percent downpayments in 1981 lost their home. 27 percent of buyers making three percent downpayments lost their home. Incredibly, 38 percent of buyers that utilized 100 percent financing in 1981 lost their homes.

Data from a May 1989 GAO study confirms that for every year between 1980 and 1984, foreclosure rates on five percent down FHA loans exceeded ten percent. Foreclosure rates on loans with three percent downpayments exceeded 15 percent. Foreclosure rates on loans with downpayments under three percent were at or above twenty percent in each year, peaking at 40 percent in 1982. When two in five households using federal insurance to buy a home ends up being foreclosed on, everybody --- the homebuyer, the neighborhood, and the government --- ends up losing.

Community groups know what goes into designing a sound mortgage lending program. Since 1984, we have used the Community Reinvestment Act to develop over $3 billion in lending agreements with banks. Typically, these agreements provide mortgages with five to ten percent downpayments for homes in previously redlined inner-city areas. However, default rates on these loans have been quite low. Lenders like First National Bank of Chicago, Ameritrust Development Bank of Cleveland, and Boatmens Bank of St. Louis have provided tens of millions of dollars in such loans for years with default rates below one percent.

I believe that affordable homeownership is consistent with loan soundness. The lesson resulting from many CRA agreements is that when borrowers save a five percent downpayment, when community groups help prepare less sophisticated buyers for homeownership, and when banks provide hands-on and thoughtful loan servicing, foreclosure rates on home loans to low-income households are surprisingly low. Unfortunately, FHA inner-city loans often end up serving families who have saved practically no downpayment, are inadequately prepared for homeownership, and have their mortgage serviced by an out-of-state mortgage company that can only be reached through an "800" phone number. While this is obviously a simplified example, it all too often explains why foreclosure befalls urban FHA borrowers that deserve better.

Proposals To Expand FHA

The proposed liberalization of FHA would make homeownership less safe but no more affordable. The FHA insurance fund already has problems that need to be addressed. Those problems will only be aggravated by utilizing more ARMs and lower downpayments that will create higher risk. Most important, these steps don't even address the legitimate housing affordability problems the National Affordable Housing Act points to.

The Act would increase FHA's current high-cost limit of $101,250. FHA ceilings would instead be set at 95 percent of local median sales price, as much as $180,000 in areas of California and New England.

The Act thus defines America's housing affordability problem as a problem that is being experienced in only a few high-cost markets. In four out of five metropolitan areas, the median home sales price falls below current FHA limits. Last year, fully 15 percent of all new FHA loans --- 80,000 loans for over $8 billion --- were originated in high-cost California. If one out of six FHA loans are originated in a state as expensive as California, it is hard to believe that FHA is out of touch with high-cost housing markets.

In these high-cost markets, the lower downpayments offered by FHA would make homes less affordable. Middle-income buyers in these markets typically save higher than normal downpayments, because that is the only way to bring mortgage costs down to affordable levels. In the Northeast, where housing is least affordable, first-time buyers have had to save an average downpayment of 19 percent --- higher than anywhere else. Even so, Northeastern first-time buyers still have to spend an average of 39 percent of income on housing.

Raising FHA mortgage ceilings does nothing for families making under $40,000 that are the real victims of skyrocketing home prices. Higher FHA limits will benefit only one group of people: rich homebuyers who prefer the instant gratification of a loan with almost no downpayment. The National Affordable Housing Act would enable FHA to finance a $180,000 home with a downpayment of less than $6,000. For an eligible buyer making $75,000 or more, that's about one month's pay. It's a sham to suggest that such buyers represent mainstream America. Let's not create national housing policy to suit their pleasures.

Other proposed changes in FHA would impact borrowers at all income levels, but only in a negative way.

The Act would enable FHA to utilize more types of adjustable-rate mortgages, such as ARMs that can increase two points a year with a five or six percent lifetime cap. In order

to qualify, borrowers would have to be able to afford a loan after its first maximum adjustment occurred. Normally, ARM rates are no more than two points lower than rates for fixed-rate loans. So in reality, FHA would only qualify homebuyers to use ARMs if those buyers could afford a fixed-rate loan. ARMs won't make anyone eligible for an FHA loan that couldn't already afford a fixed-rate loan.

ARMs wouldn't increase eligibility, but they would increase risk. I have attached an excerpt from Moody's Structured Reports on the MI Industry that clearly details this risk. Of low downpayment loans originated between 1980 and 1984, when interest rates rose and then stabilized at high levels, foreclosures were twice as high on ARMs than on fixed-rate loans. In 1985 and 1986, foreclosure rates on ARMs and fixed-rate loans were similar, since interest rates were declining. The common sense conclusion: when interest rates and monthly payments increase, ARMs create much higher risk.

Some industry analysts argue that today's ARMs are safer because they contain interest rate increase caps. No one can really guess what future experience with ARMs will look like. But even supporters of ARMs agree that they are best suited to higher-income families with greater net worth or good potential for increased income, which can offset increases in monthly mortgage payments. Of course, households that rely on FHA tend to have the opposite characteristics: stable income and relatively little savings. Why reorient FHA to loan instruments that are best suited for families FHA wasn't intended to serve? This Committee should prohibit the use of ARMs by FHA.

It flies in the face of all logic to suggest that homebuyers that can't save a five percent downpayment can afford ARM mortgage payments that could actually double in a period of a few years. Who's kidding who? Using ultra-low-downpayment FHA ARMs to expand homeownership reminds me of the argument that deregulation would shore up the thrift industry. This is yet another witches' brew that could lead to a catastrophe rivaling the S & L crisis. Double-digit foreclosure rates in Houston and Denver suburbs provide graphic examples of what happens when unsound mortgage instruments are used to fuel speculation on overpriced homes.

I also urge this Committee to maintain FHA's current minimum downpayment limits. Catastophic foreclosure rates associated with three percent downpayment loans harm the homebuyers who default, the neighborhoods that absorb the foreclosure, and the FHA fund that absorbs the loss.

Alternative Homeownership Opportunity Proposals

None of the proposals in the National Affordable Housing Act address the real victims of the homeownership affordability

crunch. In fact, the Act could actually decrease the ability of moderate-income families to purchase and keep a home. Higher FHA mortgage limits would put upward pressure on home costs. They would help mortgage brokers using FHA to ignore low-value homes. As a result, mortgage credit would be less available to households typically served by FHA. Increased use of ARMs and lower downpayments would drive up foreclosure rates and stigmatize many neighborhoods as "bad risks."

A sound program to expand homeownership affordability would encourage families to save downpayments that will increase their ability to purchase and keep homes. The National Affordable Housing Act proposes to do this by allowing first-time homebuyers to use funds in their IRA's or 401(k) retirement plans for investment in a home. This proposal would promote savings and loan soundness. However, the method it prescribes for saving a downpayment is not a very equitable one. The federal government would provide a homeownership subsidy, in the form of a tax expenditure, but only to a relatively small percentage of homebuyers that would tend to have higher incomes. Homebuyers with company retirement plans, or households that prefer or require less rigid savings instruments, could not receive the subsidy. Homebuyers who used retirement accounts to buy homes could also be faced with a double whammy: losing their home and their life savings in one stroke.

NPA proposes a number of alternative steps to expand homeownership rates among households that are falling into the affordability gap:

Enact the HOME Program

NPA and the Mortgage Insurance Companies of America (MICA) have jointly designed an alternative homeownership opportunity program --- the Home Ownership Made Easier (HOME) program. The program is targeted to the following people:

- households making less than 120 % of area median income, or about $40,000 on a national basis, that often can't afford to buy median-priced starter homes;
- households that are saving downpayments of five percent or more but still can't afford today's high monthly mortgage payments.

The HOME program would help families to help themselves by providing a dollar-for-dollar federal match to a household's downpayment savings. For example, a moderate-income family that saved $3,000 would receive a $9,000 match. This match would become a low-interest second mortgage that would be repaid to the federal government at an interest rate ranging from three to nine percent. This small subsidy could increase a homebuyer's purchasing power by as much as twenty percent. Further details on the HOME Program are attached to my testimony.

The HOME Program is a sound alternative to Title II of the

National Affordable Housing Act. Rather than lowering downpayments to dangerous levels, the HOME plan would encourage families to save a downpayment of five percent or more. Unlike the proposed FHA expansion, the HOME program would reduce actual housing costs by as much as twenty percent. The HOME plan would utilize fixed-rate mortgages, pioneered by FHA decades ago, that have proven to be the soundest alternative for modest-income families.

Finally, the HOME program would be a cost-effective way to address our homeownership affordability gaps. The HOME program would cost $200 million to $600 million a year. These expenditures are lower than the loss generated by FHA in 1988. The costs of the HOME program are also lower than the tax expenditures that could result from the less equitable use of retirement plans for downpayments.

Lower the Cost of New Homes

Homeownership opportunities will continue to decline as long as new home prices continue to escalate ten percent or more a year. Creative approaches are needed to actually lower the cost of new homes, rather than using unsound financing to make expensive homes seem affordable. As a national objective, any family should be able to buy a decent starter home for no more than $100,000 in any housing market.

The recent national demonstration program sponsored by the Department of Housing and Urban Development and the National Association of Home Builders (NAHB) demonstrated that savings of as much as twenty percent in new home price can be achieved by variances in local zoning and building codes, without sacrificing quality. However, the demonstration didn't extend beyond the typical middle-class, suburban home. The lessons learned from this demonstration could be promoted aggressively by the federal government, and further demonstrations should be encouraged that extend deeper into the homebuying population.

As a start, National People's Action is proposing a ten city homeownership demonstration program to the NAHB that would result in development of 1,500 housing units costing no more than $50,000 each. Such homes could then be replicated nationwide in moderate-income neighborhoods.

Promote the Availability of Five Percent Down Loans

NPA has spent two years on an effort that has resulted in liberalization of a broad range of Fannie Mae and private mortgage insurance eligibility guidelines. These changes should make it at least somewhat easier for all first-time homebuyers to qualify for a five-percent-down conventional loan. However, further changes are needed.

Attached to my testimony is a description of a demonstration program we have developed with Fannie Mae, General Electric

Capital Mortgage Insurance Companies, Mortgage Guaranty Insurance Corporation, and several dozen financial institutions. The program will help inform secondary markets and mortgage insurers on how to soundly insure and purchase "nonconforming" low downpayment mortgages that actually have good loan payment records. NPA believes that in the past, secondary mortgage markets and private mortgage insurers failed in their responsibility to purchase and insure sound loans in urban areas. Today, we feel that both industries are moving aggressively in the right direction. This movement should be encouraged by the federal government.

Require S & L's To Provide Low Interest Community Loans

This country is about to embark on an estimated $200 billion dollar bailout of our thrift industry. Much of the massive losses racked up by S & L's can be attributed to abuse, speculation, and deregulation that encouraged lenders into areas they were not expert in. At this point, taxpayers have no choice but to shore up a thrift industry that is still the cornerstone of our housing finance system. However, this bailout should result in what I would call the biggest CRA agreement ever. S & L's receiving government funds should be required to provide affordable home financing, at below-market interest rates, to moderate-income homebuyers. These investments will not only serve an important social purpose, they will serve an economic one: soundly underwritten mortgage loans to moderate-income families have proven to be far more sound than many of the speculative ventures thrifts invested in over the past decade.

Federal mandates to expand the Federal Home Loan Bank Board's Community Investment Fund would provide additional resources for thrifts receiving federal assistence to in turn provide assistance to moderate-income homebuyers through affordable interest rates.

Enact NPA's National Housing Trust Fund

The National Affordable Housing Act proposes a national Housing Opportunity Program and other measures that would increase the federal housing budget $4.1 billion above the CBO base-line for 1990. National People's Action is in support of efforts to restore federal housing support that was decimated in the past decade. However, the HOP program would barely scratch the surface of existing housing need.

NPA proposes a National Housing Trust Fund that would be different than the HOP in several important respects. Most importantly, it would provide a self-funding mechanism. Reasonable sources of revenue for the Fund could include:

- a universal fee on residential real estate transfers,
- a fee on mortgage-backed securities,
- a portion of the homeowners interest deduction for the highest priced homes.

NPA recommends that the Housing Trust Fund be initially funded at an annual level of $20 billion: 85 percent from the federal government, and 15 percent from state and local government matches. Funds would be made available on a block-grant basis for the construction or rehabilitation of single-family or multi-family housing.

The Housing Trust Fund will also guarantee that private sector investment remains a viable option in low- and moderate-income housing strategies. The reality is that most housing for the poor or even low-income working families can not be created solely with private funds. Often, a small investment by the federal government to increase affordability or lower risk will leverage much larger private investments. In Chicago alone, for example, five local financial institutions have already pledged $338 million in bank funds for community revitalization loans. Over $135 million of these funds are already lent. However, the overwhelming majority of these loans required some type of subordinate investment by the public sector. So every $1 increase in housing funds appropriated by the federal government can result in $2, $5, or more invested by private corporations.

Stabilizing the FHA Insurance Fund

The ink hasn't even dried on the $200 billion dollar check the American people are writing to bailout our thrift industry. Yet here we are discussing steps that will almost certainly create the conditions for a massive FHA bailout a few years down the road. The catastrophe I predict if these FHA proposals are enacted will actually be worse than the S & L disaster. Fortunately, the government stepped in to protect insured savings that were jeopardized. When low downpayment FHA ARMs jeopardize our homes, no one will be able to protect them.

I urge this Subcommittee to stop plans to expand FHA and focus on fixing the problems it already has. Consideration should be given to the following proposals:

Institute Mandatory Prepurchase Counseling

In urban areas where FHA is providing the majority of housing finance, realtors and mortgage brokers have often qualified first-time homebuyers who are not adequately prepared for homeownership. In areas with high FHA concentrations, mandatory prepurchase counselling for all applicants making low downpayments would significantly lower deafult rates.

Require Disclosure of FHA Loans

The Department of Housing and Urban Development should be required to disclose the geographic location, by census tract, of FHA-insured originations and foreclosures. This information

could be used by local governments and community groups as an early warning system to prevent high concentrations of FHA-insured loans and FHA foreclosures. The legislation could be modeled after the federal Home Mortgage Disclosure Act.

High concentrations of FHA loans have proven to be unsound for any neighborhood. HUD need not be an innocent bystander in the national effort to end mortgage redlining by financial institutions. Under the new fair housing regulations, HUD can require the Justice Department to prosecute mortgage lending decisions that violate fair housing. The Congress should direct HUD to aggressively utilize this new anti-redlining tool.

Increase Mortgage Assignments

A typical FHA foreclosure costs HUD as much as $20,000. At this cost, FHA should be seeking more alternatives to foreclosing on delinquent borrowers. The mortgage assignment program has been a vastly underutilized resource for preventing foreclosure.

Decertify Mortgage Brokers With High Foreclosure Rates

One factor stands above all others in determining whether or not a loan will default: the lender that originated it. A recent study by the Mortgage Guaranty Insurance Corporation found that loans originated by mortgage brokers were more than five times more likely to default than other loans. 28 percent of all loans originated by brokers defaulted, while only five percent of loans not originated by brokers defaulted. These figures confirm what inner-city residents have long known: some mortgage brokers don't care what happens once their fees are paid. I'm pleased to have led a national effort that resulted in prosecution and decertification of mortgage brokers that knowingly qualified unprepared and uncreditworthy borrowers.

Congress could do a great service to future homebuyers by forcing FHA to finally decertify the rip-off artists that prey on unsophisticated borrowers.

These proposals would stabilize the FHA mortgage insurance fund, prevent thousands of unnecessary foreclosures, and help restore the image of FHA as a supplier of decent, sound, and affordable housing credit.

Reinstate the FHA Repair and Sell Program

For a few promising years in 1979 and 1980, NPA worked with HUD to develop an innovative Repair and Sell program for FHA foreclosures. In neighborhoods of Chicago and Cleveland with chronically high FHA default rates, HUD worked with community groups to restore neighborhood homes. HUD identified and hired contractors that rehabiliated FHA foreclosures. For their part, community groups marketed the homes and identified qualified buyers. The program made a profit.

Today, community groups have far more sophisticated development skills than they did just ten years ago. Yet it can be next to impossible to negotiate with HUD to obtain foreclosed properties at a cost that will sustain rehabilitation. Congress could further promote housing revitalization by encouraging the reinstatement of the HUD Repair and Sell Program.

Conclusion

Senator Cranston and Members of this Subcommittee, I appreciate this opportunity to provide some candid views on a problem that greatly concerns residents of urban neighborhoods. I appreciate your leadership in focusing greater attention on this problem. And I certainly understand the frustrations that go along with trying to make housing more affordable during a time when the federal government has limited resources to offer.

I believe that by joining forces in creative ways, we have it within our power to address the challenges that confront us, despite the fact --- or perhaps because of the fact --- that the federal government can no longer play a dominant role. Community groups across the country are hard at work building thousands of affordable housing units. Thanks to the Community Reinvestment Act, financial institutions are pumping billions of dollars into previously redlined housing markets. Working with NPA, private mortgage insurers and Fannie Mae have developed an innovative demonstration program that will provide more affordable home loans to thousands of inner-city residents, and will ultimately change MI and secondary market lending standards. And we have started a promising dialogue with the National Association of Home Builders that we think will result in a cooperative effort to lower the cost of new homes so that more households can afford them. And that's just what National People's Action has done!

FHA's many successes offer a simple but profound lesson: government can often help the most by making it easier for the private sector to do the job. That's what FHA insurance has done for decades. Through the power of good example, FHA created booming conventional mortgage finance and private mortgage insurance industries. Today, I fear the opposite is happening. FHA would mimick some of the worst failures of conventional lenders and MIs by bending over backward to insure overpriced homes using mortgage instruments whose fundamental lack of soundness has been well documented.

The alternative proposals I have made need to be further developed, and even stronger innovations may emerge from our discussions. But I know intuitively that when community groups can agree with mortgage insurers and bankers and other corporate providers of housing, we're on to a great idea. I trust that upon further consideration, this Subcommittee will amend Title II of the Affordable Housing Act and give serious consideration to enacting our Home Ownership Made Easier (HOME) and Housing Trust Fund proposals.

Thank you, Mr. Chairman.

NATIONAL PEOPLE'S ACTION

NEIGHBORHOODS *First*

WHY THE HOME PROGRAM?

1. THE HOME PROGRAM IS DIRECTED TO THOSE WHO ARE HAVING THE MOST DIFFICULT TIME BUYING A HOME TODAY:

   - o families earning 120 percent or less of median income
   - o nationally, families making under $40,000 a year

2. THE HOME PROGRAM WOULD DO WHAT THE PROPOSED EXPANSION OF FHA DOES NOT: EXTEND THE MARGINS OF ELIGIBILITY FOR HOMEOWNERSHIP:

   - o lowering FHA downpayments actually increases the income level needed to qualify for a home
   - o the HOME program offers low five percent downpayments, and federal second mortgages that would lower monthly housing expenses by as much as 20 percent

3. THE HOME PROGRAM WOULD PROMOTE SOUND HOMEOWNERSHIP AND MINIMIZE FORECLOSURES

   - o FHA use of three percent down adjustable-rate mortgages would increase foreclosures and government costs
   - o HOME program would encourage potential homebuyers to save, lower monthly housing costs, and utilize fixed-rate loans, all of which would increase loan soundness

4. THE HOME PROGRAM WOULD INVOLVE ONLY MODEST EXPENSE TO THE FEDERAL GOVERNMENT

   - o The program would cost nothing for two years, and $200 million to $600 million per year in the following four years
   - o Over time, the program would break even or could result in a slight profit
   - o The program would encourage partnerships between the private sector and community groups to best resolve housing problems

NATIONAL PEOPLE'S ACTION

NEIGHBORHOODS *First*

THE REAL HOME AFFORDABILITY PROBLEM

The proposed expansion of FHA loans would permit homebuyers in some markets to utilize federal mortgage insurance on homes as expensive as $200,000. Families making $80,000 or more would qualify for such homes. This expansion would clearly redirect FHA to serving affluent markets it was not intended to serve.

America has a real homeownership affordability problem, but the problem exists primarily for low- to middle-income families, not upscale families making $80,000 a year.

The problem has been caused by the rapid increase in the cost of buying a home. For example, the cost of a first home has increased dramatically in recent years:

	1988	1986	1976
Median home price, first-time buyers	$ 97,100	$ 74,700	$ 37,670

As a result, those families that can afford to buy a home have to spend an increasing percentage of their income on monthly mortgage payments:

	1988	1986	1976
Average monthly payment as % of income, first-time buyers	34.8 %	31.8 %	23.0 %

Increasingly, monthly mortgage payments --- and homeownership --- are simply not affordable for low-, moderate-, and even some middle-income families. Every year, becomes more and more a priveleage for affluent families, rather than an opportunity for moderate-income families to achieve the American dream:

	1988	1985
Distribution of household income for all first-time homebuyers:		
Less than $30,000	18.3 %	25.8 %
$30,000 - $40,000	21.8 %	33.2 %
$41,000 - $50,000	22.6 %	19.6 %
$51,000 - $60,000	15.4 %	11.6 %
$61,000 or more	21.9 %	8.8 %

The problem is not that families making $60,000 or more can't afford homes, but that families making $40,000 or less can't afford them.

FACT 1: FAMILIES IN HIGH COST AREAS NEED LARGE DOWNPAYMENTS TO AFFORD HIGH MORTGAGE COSTS. LOWER DOWNPAYMENTS WOULD SIMPLY INCREASE ALREADY HIGH MORTGAGE PAYMENTS:

for first-time buyers in:	New York	Chicago	Memphis
median home price	$ 181,200	$ 86,600	$ 61,200
median buyer income	$ 52,100	$ 42,200	$ 37,500
average downpayment	22 %	16 %	10 %
average monthly payment	$ 1,310	$ 758	$ 585
average payment as % of income	47 %	33 %	29 %

FACT 2: FAMILIES MAKING UNDER $40,000 ACCOUNT FOR THE DECLINE IN HOMEOWNERSHIP RATES:

income level of first-time buyers in:	1988	1985
up to $40,000	40 %	59 %
$41,000 to $60,000	38 %	31 %
over $60,000	22 %	10 %

FACT 3: FIRST-TIME BUYERS CAN SAVE REGULAR DOWNPAYMENTS. HOWEVER, EVEN REGULAR DOWNPAYMENTS ARE INADEQUATE WHEN BUYERS DON'T HAVE THE INCOME TO COVER HIGH MONTHLY MORTGAGE COSTS:

for first-time buyers in:	1988	1976
median home price	$ 97,100	$ 37,670
average monthly payment	$ 929	$ 313
average payment as % of income	35 %	23 %
average downpayment	15 %	18 %
average years to save downpayment	2.4	2.4

CONCLUSION: FEDERAL HOMEOWNERSHIP POLICIES SHOULD TARGET FAMILIES MAKING LESS THAN $40,000 A YEAR.

THESE FAMILIES CAN STILL SAVE A NORMAL DOWNPAYMENT IN THE SAME TIME IT TOOK A DECADE AGO.

THE TWO FACTORS REDUCING HOMEOWNERSHIP ARE EXCESSIVE HOME PRICES AND MONTHLY MORTGAGE COSTS.

LOWER DOWNPAYMENT FHA MORTGAGES WILL NOT ADDRESS THESE PROBLEMS

SOURCE: Chicago Title and Trust 13th Annual Survey of Recent Home Buyers

NATIONAL PEOPLE'S ACTION

NEIGHBORHOODS First

May 21, 1989

Down payment as low as 5% offered to some

REAL ESTATE

By Pamela Reeves
Scripps Howard News Service

People in five Midwestern cities with incomes between $15,000 and $40,000 are being offered a special chance to buy homes through a program that eventually could expand nationwide.

Starting out in Chicago, St. Louis, Cincinnati, Cleveland and Indianapolis, the idea is to demonstrate to lenders that urban buyers with moderate incomes make good customers.

Here's how it works:

Lenders taking part in the program will make it easier for potential home buyers to qualify for a mortgage: The down payment required is only 5 percent, buyers don't have to have two months' worth of mortgage payments in reserve, and they can use up to 33 percent of their gross monthly income to pay for the mortgage, insurance and property tax.

Under this formula, a family earning $25,000 a year would be able to buy a house in the $65,000-$70,000 range.

Normally, if home buyers can even find a mortgage that requires just 5 percent down, lenders insist they have money in reserve for future mortgage payments, and the ceiling on the housing payment is 28 percent of gross income.

The push for this program came from the National Training and Information Center in Chicago, a nonprofit group. The Federal National Mortgage Association (Fannie Mae) has agreed to buy the loans from lenders taking part. And GE Capital Mortgage Insurance Co. will provide the private mortgage insurance.

Tom Schraw, housing coordinator at the National Training Center, said that to qualify for the program, a buyer would need to have a good credit history and a steady job.

He said that in each of the cities chosen for the pilot program, houses in acceptable neighborhoods are available for less than $100,000.

"In a lot of these cities, housing values are low enough (that) you can buy a decent house for $30,000," Schraw said.

All the loans in this program will be made to people who buy within the city limits. Lenders are frequently wary of making such loans because property values don't rise much in most inner-city neighborhoods and many loans made in such areas in the '70s went bad.

But Schraw said that both lenders and housing activists have learned what kind of people are good risks.

"Income has nothing to do with loan soundness," he said. "Someone who makes $15,000 would be just as likely to pay their bills as someone who makes $50,000."

What does make a difference, he said, is whether the buyers make a down payment and have a good credit history and a steady job.

Most lending requirements are designed "more for upscale families buying houses in the suburbs," Schraw said. This pilot program is designed to accommodate the different needs of low- and moderate-income buyers in the city.

The program is available through Talman Home Mortgage Corp. in Chicago; Boatmen's Bank in St. Louis; Fifth Third Bank, Star Bank, and Huntington Mortgage Co. in Cincinnati; Ameritrust Development Bank and Huntington Mortgage in Cleveland; and Bank One, Indiana National Bank and Merchants National Bank in Indianapolis.

Whether the program will be expanded depends on what happens in the pilot program.

CONTACT: Tom Schaw, Gale Cincotta — NTIC (312) 243-3035
Jeannette Barney, Mark Goldfeder — GE Capital Mortgage Insurance (800) 334-9270
Terry Puster — TMG International (314) 241-6100

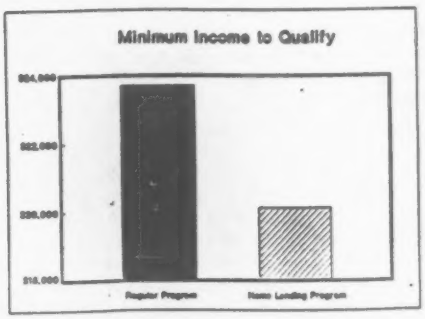
FACT SHEET

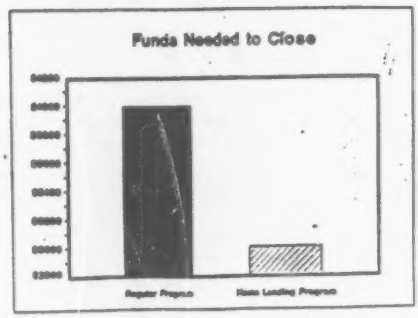
HOW THE HOME LENDING PROGRAM INCREASES AFFORDABILITY

- Less income required to qualify
- No mandatory reserve
- Less money needed to close

On a typical $50,000 house, as illustrated in the 95% LTV example below, this translates into the borrower needing 15% less income to qualify for the mortgage, and 28% less funds at closing.

	Regular Program (example)	Home Lending Program (example)
Debt Ratios	28/36	33/38
Monthly Payment	$553	$553
Minimum Income to Qualify	$23,700	$20,110
Downpayment (5%)	$2,500	$2,500
Mandatory Reserve	$1,000	0
Total $ Required to Close	$4,000	$3,000
Collateral		Under the home lending program, GE and Fannie Mae will view properties in inner-city neighborhoods with more flexibility.





This example of how the program might work assumes an 11%, 30-year, fixed-rate loan with $100 per month for taxes and insurance, with the seller paying customary closing costs and the buyer paying a $600 (1%) mortgage insurance premium.

Moody's Investors Service

STRUCTURED FINANCE
Research & Commentary

JUNE 1987

SPECIAL REPORT

Moody's STRUCTURED FINANCE

SPECIAL REPORT:

Moody's Annual Report of the Private Mortgage Insurance Industry

Risk By Loan Instrument

The claim frequencies presented in Graph 5 were greatly affected by the experience of new types of insured mortgage instruments, the full risk potential of which was unknown at the time of their introduction. Development of new types of loan instruments has introduced new elements of risk, some aspects of which are speculative in nature and cannot be actuarially defined. These instruments were originally designed to address the issue of housing affordability. By 1979, high interest rates and continued home-price inflation had made home ownership difficult for many first-time homeowners. Adjustable-rate mortgages were later introduced, not only to reduce early-year interest costs, but also to provide intermediaries with a reduction in interest rate risk.

Differences in loan types affect both the borrower's equity position and his ability to make payments. Payments on normal, fixed-rate conventional loans are level, with speed of principal repayment determined by the coupon rate and the term to maturity. As long as a homeowner maintains employment and incurs no additional debt, his ability to meet monthly payments will not likely be affected. Many of the new loan instruments involve scheduled or potential changes in monthly payments. Such loan instruments assume that a borrower's income will increase over time at some minimum growth rate to meet the planned or unplanned adjustments to monthly payments.

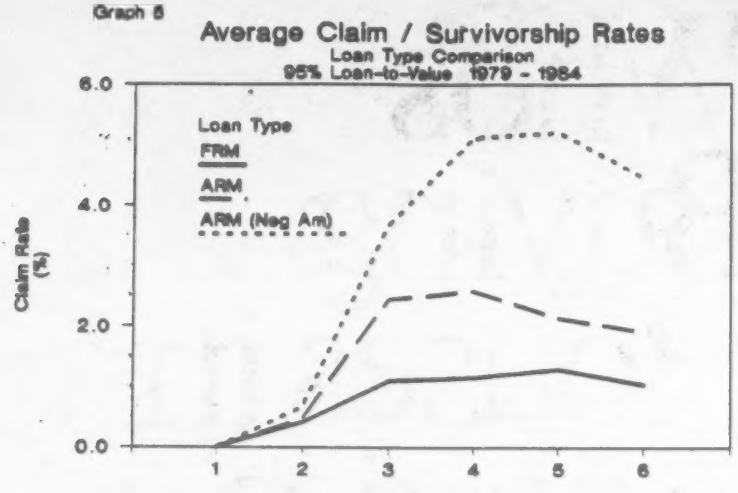
Examples of the various loan types and their effect on payments and net equity vary considerably. Most graduated-payment mortgages have fixed interest rates but schedule payment increases, as well as planned limited negative amortization, in the early years of the mortgage. Growing-equity mortgages (GEMs) have no negative amortization but do have scheduled payment increases, which rapidly increase the borrower's equity position. Builder buydowns were introduced to reduce monthly payments in the early years of loans. Depending upon the size of the buydown, monthly payments increase to full regular payments within one to three years. Quite often, the cost of buydowns is recaptured in the price of the home, distorting the true initial loan-to-value ratio.

ARMs potentially can include all of the above characteristics, depending on what loan features have been adopted for a particular loan. The variety of features in ARMs makes this particular instrument difficult to assess and to track over time. However, there has been a marked trend toward greater standardization in ARM instruments, which will improve our ability to assess the risk exposure presented to mortgage insurers.

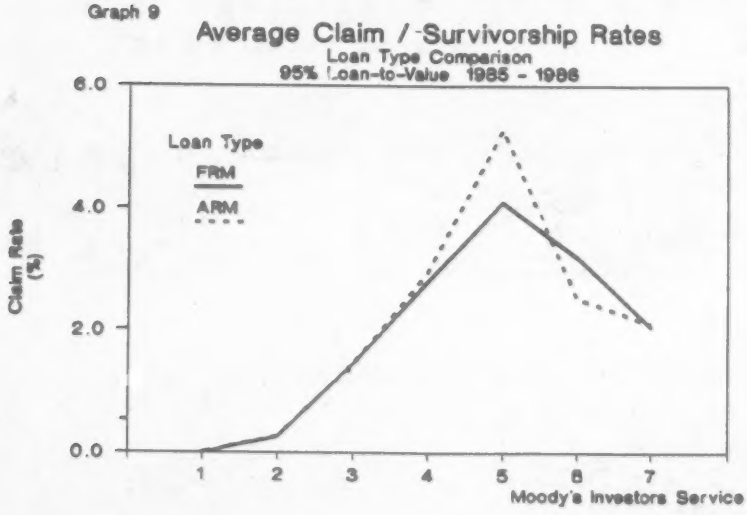
In the graphics that follow, the claim termination rates of fixed-rate, fixed-payment mortgages (FRMs) are compared with sets of claim rates of nonconventional loan types for the 91%-95% loan-to-value group. Except where noted, the claim experience is for loans originated between 1980 and 1986.
Comparisons of the default frequencies of fixed-rate, fixed- payment loans with ARM products has changed in recent years relative to experience of the early 1980s. The first ARM products were often underwritten by qualifying borrowers at teaser rates rather than at indexed rates. All too frequently, such first-year rates were more than 250 basis points below indexed rates. Such a structure guaranteed substantial payment increases at the anniversary date, and if interest rate changes were capped, often guaranteed a second increase the year after that. When negative amortization was permitted or even scheduled (as in a GPM with an adjustable rate), the chances for default were substantially increased. Graph 8 displays the average claims/survivors rates for 95%-LTV fixed-payment loans, fully amortizing ARMs, and ARMS permitting or scheduling negative amortization, for the years 1980-84 by policy year. This experience clearly branded ARMs as a high-risk product.

With the decline in interest rates in 1985-86, the required payments on most ARMs were reduced each year (three- and five-year ARMs have less frequent changes). The payment-to-income ratio for most ARM borrowers fell below that of fixed-payment borrowers. Lower interest rates also meant a faster repayment of principal. As a result, the performance of fully amortized ARMs, especially those written under tighter underwriting criteria, improved dramatically and compared favorably with the performance of fixed-payment mortgages over 1985-86, as shown in Graph 9. This performance will continue only so long as interest rates remain at the low levels of 1986. Rising interest rates, which could present a sharp change in payments and a squeeze on net equity permitted by negative amortizing ARMs, could push claim rates back to higher levels.

Graph 8



Graph 9



Who's Buying Houses in America...

Chicago Title's 13th Annual Survey of Recent Home Buyers

Characteristics	1988	1987	1986	(Base Year) 1976
Two-income families	77.7%	78.3%	74.4%	N/A
First-time buyers	85.5	86.4	83.8	N/A
Repeat buyers	73.3	73.6	70.1	N/A
Down payment as % of sales price	24.0%	27.2%	23.4%	25.2%
First-time buyers	14.6	20.4	13.4	18.0
Repeat buyers	29.7	31.3	28.9	30.8
Down payment of:				
10% or less	38.9%	41.5%	46.0%	26.9%
20% or less	62.7	64.4	68.7	60.2
More than 50%	10.8	15.7	12.6	13.8
Type of mortgage financing				
Conventional fixed rate	53.1%	67.6%	73.3%	N/A
Adjustable or variable rate	41.8	19.8	13.6	N/A
Seller financed or contract loan	1.6	1.2	2.3	N/A
Other	3.5	11.4	10.9	N/A
Length of mortgage (years)				
First-time buyers	28.5	28.4	28.7	N/A
Repeat buyers	27.8	28.4	27.0	N/A
Average down payment breakdown (% of dollars)				
Of first-time buyers				
Own savings and investments	77.1%	81.9%	77.9%	80.1%
Lending institutions	2.5	6.1	6.0	4.5
Relatives	11.6	9.2	14.3	10.8
Others	8.8	2.8	1.8	4.0
Of repeat buyers				
Previous home sale	51.9	57.1	50.3	N/A
Savings and investments	38.3	33.3	40.1	N/A
Lending institutions	1.6	5.2	4.4	N/A
Relatives	2.6	1.7	2.1	N/A
Others	5.6	2.7	3.1	N/A
Average time to save down payment (years)				
First-time buyers	2.4	2.4	1.8	2.4
Average family size	2.9	3.0	3.0	N/A
First-time buyers	2.7	2.9	2.7	N/A
Repeat buyers	3.1	3.0	3.1	N/A
Median household income	$55,200	$51,500	$46,620	$20,840
First-time buyers	48,300	43,800	38,920	20,480
Repeat buyers	59,500	56,300	53,120	21,080

N/A—Not available

Characteristics	1988	1987	1986	(Base Year) 1976
Median price of home purchased	$121,910	$ 99,260	$ 93,680	$43,340
First-time buyers	97,100	84,730	74,700	37,670
Repeat buyers	141,400	115,430	114,860	50,090
Average price of home purchased	$145,500	$133,410	$114,780	N/A
First-time buyers	119,900	106,450	82,510	N/A
Repeat buyers	161,200	149,390	132,430	N/A
Average monthly payment	$1,008	$ 939	$ 852	$329
First-time buyers	929	841	722	313
Repeat buyers	1,060	998	929	342
When household income is:				
less than $30,000	690	704	628	N/A
$30,000-$40,000	761	713	647	N/A
$41,000-$50,000	893	840	820	N/A
$51,000-$60,000	1,040	891	902	N/A
$61,000 or more	1,305	1,362	1,148	N/A
Average monthly payment as % of income	32.8%	29.3%	28.6%	24.0%
First-time buyers	34.8	31.8	30.3	23.0
Repeat buyers	31.4	27.6	27.5	24.9
Buying for the first time	37.8%	36.8%	35.5%	44.8%
Previously owned a home	62.2	63.2	64.5	55.2
Average age of first-time buyers	30.3	29.6	30.9	28.1
Average age of repeat buyers	38.9	39.1	39.5	35.9
Average number of houses looked at	14.2	11.6	15.1	12.3
Average number of months buyers looked before deciding	4.7	4.5	4.6	4.0
First-time buyers	5.0	4.6	5.0	4.3
Repeat buyers	4.4	4.4	4.4	3.8
Bought new houses	26.2%	23.8%	25.7%	15.1%
Bought used houses	73.8	76.2	74.3	84.9
Bought single-family homes	83.3%	87.3%	85.1%	88.8%
Bought multi-family homes	3.8	0.4	5.2	N/A
Bought condominiums	12.4	12.5	14.2	11.2
Bought co-ops	0.5	0.2	0.7	N/A
Married	77.0%	81.7%	78.8%	N/A
Widowed	2.0	1.7	1.4	N/A
Divorced/Separated	8.4	6.9	7.7	N/A
Single	12.6	9.7	12.2	N/A

N/A—Not available
Source: Chicago Title and Trust Co.

United States General Accounting Office

GAO

Briefing Report to the Chairman, Committee on Banking, Housing and Urban Affairs, United States Senate

May 1989

FINANCIAL MANAGEMENT

Federal Housing Administration's Accounting Methods and Section 203 (b) Program

GAO/AFMD-89-26BR

APPENDIX I

SECTION II

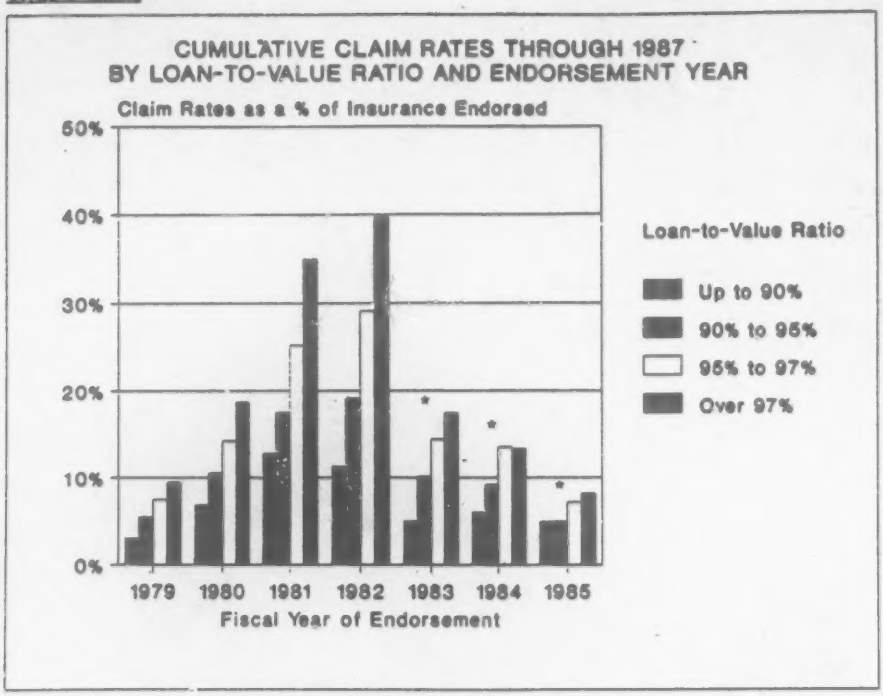
ANALYSIS OF LOAN-TO-VALUE RATIO: MMI FUND INSURED MORTGAGES

- IN RECENT YEARS, IT APPEARS AS THOUGH THE MMI FUND IS INSURING MORTGAGES WITH MORE FAVORABLE LOAN TO VALUE RATIOS
- CLAIM RATES ARE BETTER FOR INSURED MORTGAGES WITH MORE FAVORABLE LOAN TO VALUE RATIOS

APPENDIX I

SECTION II

Chart II-6



--Claim rates are higher for higher loan-to-value ratios (i.e., when the loan represents a greater portion of the mortgaged property) and vice versa.

--Higher claim rates for 1981 and 1982 endorsements can be generally attributed to the recession, which affected most of the U.S.

--Cumulative claim data for years after 1985 is not yet meaningful, since there is minimal claim experience for those years.

* The downward trend of overall claim rates after 1982 is misleading since it has been shown that, historically, a number of additional claims will result from insurance endorsed in 1983, 1984 and 1985, as indicated in the loss distribution curve at Chart III-1.

NATIONAL PEOPLE'S ACTION

NEIGHBORHOODS *First*

NATIONAL PEOPLE'S ACTION

HOUSING REPORT

FOR THE NEW HUD ADMINISTRATION

MAY 1989

TABLE OF CONTENTS

I.	Introduction	p. 1
II.	A Critique of the National Affordable Housing Act	p. 2
III.	HUD's Failure in Fair Housing	p. 5
IV.	FHA Single-Family Policies	p. 17
V.	HUD's Responsibility to the Public Housing Sector	p. 36
VI.	Loss of Subsidized Housing	p. 40
VII.	Expanding the Low-Income Housing Tax Credit	p. 42

APPENDIXES

A. Home Ownership Made Easier (HOME) Program

B. National Housing Trust Fund Proposal

C. Letter to Mr. Don Campbell

I. INTRODUCTION

This report contains the housing concerns of National People's Action (NPA). As was mentioned during our initial meeting on April 10, 1989, NPA represents over 250 grassroots, community-based organizations that have a variety of housing needs and concerns. We want you to be aware of the housing issues and problems that we encounter in our communities and that you will face as the new HUD Secretary.

Our housing issues range from home ownership to homelessness. In many ways, the issues overlap and interconnect. We need to deal with all of the issues in a comprehensive manner. We ask that you would carefully review this report, while keeping in mind that need for a comprehensive approach to addressing our nation's housing problems. We hope for a joint venture between HUD and our neighborhoods to move forward with responsive and workable solutions to the housing problems that exist.

II. A CRITIQUE OF THE NATIONAL AFFORDABLE HOUSING ACT

National People's Action is critical of any remedies that offer only "quick fixes" for the severe housing problems that menace our nation and cripple our neighborhoods. Our neighborhoods need strong, effective programs aimed at the root causes of the problems.

Expansion and Liberalization of FHA

NPA's major objection with the "Act," as it is written, is the recommendation to serve low-income communities through FHA financing programs. From NPA's standpoint this is a completely ludicrous idea that ignores the history of FHA and government-sanctioned redlining of the 1960s and 70s. We have devoted an entire section of this report to FHA. (Also, please see attached letter addressed to Mr. Don Campbell, Staff Director, Senate Housing Subcommittee.)

Restructuring of HUD

NPA raises serious concerns over the proposal to create a new federal housing burequcracy through the HOME Corporation. This would only slow down new housing policy directions and force the neighborhoods to reacquaint themselves with a new level of bureaucracy. Even with all the problems the community sector has faced with HUD over the years, it is at least a system that community people have grown to understand. Simplification, not

88

restructuring, is a better answer.

If the purpose is to make strides in our nation's housing policy through innovative programs and public-private partnerships, we need federal housing programs that draw on the partnership efforts of community groups and the private sector. The answer is certainly not the establishment of an entirely new system that will take years to put in place and stave off the efforts of the new HUD Administration.

Permanent Affordability

We need an efficient and equitable federal housing program that directs limited government subsidies into a stock of permanently affordable housing. Ongoing affordability can be guaranteed in a variety of ways, for example, resale limitations and limited equity ventures. The "Act" does not adequately address this issue of permanent affordability.

Flexibility

The financing arrangement in this "Act" is unnecessarily complex. The Housing Opportunity Program (HOP) is falsely made to resemble a private investment scheme, rather than what it is, government assistance. The "Act" sets up many hoops for neighborhood developers to jump through. Furthermore, the "Act" compartmentalizes housing programs and makes it much more difficult to meet the local housing needs which vary by local

need. Flexibility is the answer, not a complicated investment scheme.

Conclusion

In general, the "Act" has some good concepts, but, the program specifications weren't done in a responsive or efficient manner. We can not afford to waste the what little federal resources that do exist on housing projects that private developers wind up reaping enormous profits from and leaving the Federal government and neighborhoods with another housing disaster on their hands. As a nation, we must work together to develop a national housing program that is simple and meant to address the root causes of our housing crisis.

84

III. HUD'S FAILURE IN FAIR HOUSING

A. BACKGROUND

NPA has a special interest in fair housing. NPA was founded in 1973 as community groups from all over the country came together to fight against exploitation and redlining on the part of realtors, lenders, and developers. The social experts had predicted in the Kerner Commission report on the civil disorders of the 1960s that working class whites and blacks were being pitted against each other with the movement of minorities into white neighborhoods. These experts predicted that working class whites and blacks would be unable to overcome their racial prejudices.

But NPA brought together the whites and minorities from these communities. There were some white groups who tried to use the FHA scandals as a means of keeping minorities out of their communities. NPA had no place for these people. The experts predicted that the whites and minorities would not work together and that NPA would not last a month. Obviously, their predictions were wrong. We had found the enemy, and it was not us. NPA is still here, seventeen years later; whites, blacks, Asians, Hispanics, Indians -- all working together to make our communities healthy places to live.

B. HUD'S FAILURE TO MEET ITS OBLIGATIONS

The Fair Housing Act of 1968 affirmatively obligated HUD to promote fair housing. Last year Congress amended the Fair Housing Act and gave overwhelming, bipartisan support to expanding HUD's affirmative obligation. By law, HUD is the lead Federal agency in the fight for fair housing. It has the power to develop substantive regulations over all the institutional actors involved in the housing market, from realtors to lenders, from appraisers to developers, and from members of the secondary mortgage markets to those who provide hazard and mortgage insurance.

But, in many areas, HUD has not only failed to act affirmatively, it has actually violated the Fair Housing Act. We have cited examples below:

<u>HUD and the Home Mortgage Disclosure Act</u>

The Home Mortgage Disclosure Act (HMDA) requires the Secretary of HUD to disclose data or FHA loans for all FHA lenders. The law actually requires the Secretary to disclose date "in his possession" that is similar to the HMDA data. The claim was made under the past administration that HUD was streamlining its record system. This allowed the HUD Secretary to stop keeping data similar to the HMDA, thus getting around the law. Now, though, we know that HUD does have a data system with the census locations and amounts of its loans, along with identification

numbers for all FHA mortgagees. At present, HUD is violating the law and keeping secret its lending patterns from the public. This is a betrayal of the people HUD is charged to protect. It makes a mockery of the requirement that private lenders disclose, and a mockery of Secretary Kemp's own sincere commitment to hold lenders accountable for their obligations under the Community Reinvestment Act and the Fair Housing Act.

The Fair Housing Act also requires HUD to monitor its own programs to insure that they are used to further the purposes of the Act. As discussed at length in the section of this report on FHA, these programs have been used, along with the Veterans Affairs programs, to exploit racial change at the expense of all who live in older urban and rural communities. In the past, the exploitation of FHA programs for racist ends has destroyed many healthy communities. HUD has totally failed to monitor its programs.

In some cases, like Marquette Park in Chicago, community groups and fair housing groups monitored the use of FHA programs. In this case, fair housing groups even filed suit and created a special program of pre-purchase counseling to insure that home owners weren't steered into a community against their will.

We have asked HUD to monitor the use of FHA programs to identify communities, like Marquette Park, where FHA lending suddenly

moves in and dominates the lending market. In these cases, we have asked HUD to create similar pre-purchase counseling programs and to carefully monitor the lenders and realtors involved in these sales to protect the community from abuses and exploitation. Under the provisions of the new Fair Housing Admendments, HUD can initiate its own suits against these lenders and realtors. Now, HUD has tools to be much more affirmative and aggressive than when it had to wait for individual complaints.

Only HUD has the data to track the use of its programs at all times in every community. Yet, HUD not only fails to release date on its lending programs, as required under the Home Mortgage Disclosure Act, it fails to do internal monitoring. In addition, HUD does not require the other Federal housing programs of the Department of Agriculture and the Department of Veterans Affairs to monitor and disclose their lending patterns. This general lack of monitoring violates the intent of the Fair Housing Act.

The recently revised regulations for the Community Development Block Grant Program require recipients to develop a Fair Housing Plan. Recipients are required to use available public data and other resources to identify obstacles to fair housing and to develop plans to overcome these obstacles. Again, the refusal of HUD to comply with the Home Mortgage Disclosure Act makes it difficult for CDBG recipients to obtain the lending date necessary to comply with these provisions.

The HMDA is the only universally available public data on local mortgage markets. Any CDBG recipient that does not use the HMDA (or another similar local source of mortgage date) to identify obstacles to fair housing in the home lending market should not receive CDBG fund approval. Because the data are available and commonly used by scores of community groups with far fewer resources than local governments, there are no valid excuses for local governments not to do these analyses.

But there are virtually no local government agencies that regularly use the Home Mortgage Disclosure Act data to analyze the mortgage markets in their communities. The City of Boston has recently hired an outside consultant to do a one-time only study. However, this is not for the Fair Housing Plan. The City of Chicago has finally been forced by public pressure to use its own city disclosure data to develop a book defining the lending profiles of all lenders covered by the HMDA, yet, it does not even me.. on the issue of race in this report. Aside from this, we know of virtually no effort by local governments to use the HMDA.

According to a study by NTIC three years ago, over two hundred community groups have used the HMDA to review the performance of local lenders. Last year, both the Atlanta Constitution and the Detroit Free Press used the HMDA to do major studies of the obstacles to fair lending in their respective city. The Atlanta

paper won the Pulitzer Prize for best investigative reporting for its series. Neither the Detroit nor Atlanta city government, both recipients of CDBG monies, makes any use of the HMDA to define obstacles to fair lending. Surely, if so many community groups and newspapers are capable of doing this analysis, local governments that are required by regulation to assess obstacles to fair housing could also use the HMDA data.

We note at the end of this section one last related problem with HUD in this area. HUD's regional Fair Housing Offices have developed training programs for members of local governments. Last year, some effort was made to include lending issues. This year, however, we understand that Tom Casey, in the Fair Housing Office in Washington, has eliminated the lending sessions from the training programs because he does not think local officials are capable of learning this type of analysis in such a training session. In a year when redlining has received so much pubic attention and where national stories of discrimination in lending have prompoted special bills in Congress to disclose loan application data, does HUD really intend to cancel its training sessions on investigating discrimination in lending? We have warned about field offices not responding to orders from Washington. But, now we have field offices trying to be aggressive in fair housing while having their efforts repealed from Washington.

Dr. Calvin Bradford, one of the nations leading experts on the Home Mortgage Disclosure Act, the Community Reinvestment Act and fair housing was cancelled from the training session schedules for Chicago at the end of April 1988. He has been the leading researcher in this area and a teacher for over fifteen years. Local government officials who are required to assess obstacles to fair housing as a condition of receiving CDBG funds could have gained something from training sessions led by Dr. Bradford and other fair housing experts.

Fair Housing Regulations

In the new Fair Housing amendments, Congress has given HUD vast new powers, and reasserted the affirmative obligation of HUD to lead the Federal Government in Fair Housing enforcement. While the regulations to implement this Act have some encouraging aspects, many problems remain.

One area of concern is the definition of "substantially equivalent" state programs. In cases where HUD deems a state program to be "substantially equivalent" to the Federal Law, HUD does not intervene, but requires that cases be handled by this local process. First, HUD needs a clearly defined model state code to serve as a guideline for what constitutes "substantially equivalent" laws. Many state laws may be "substantially equivalent," yet, the process of implementing these laws is seriously flawed. In order for HUD to be affirmative in its

obligation to protect people from discrimination, HUD needs to review the performance of agencies set up to administer these state laws. Agencies which fail to implement these laws in the same affirmative fashion as HUD plans to do, should be deemed as having equivalent processes, hence, allowing HUD to take cases in these states.

Another area of concern are the regulations for implementing the Fair Housing Initiatives Program. In the past, it has been local fair housing groups that have been the backbone of efforts to advance fair housing. Congress clearly intended that this Program would assist in these efforts. However, HUD developed these regulations in concert with the National Association of Realtors. This has served to block the fair housing groups from the process entirely.

We see HUD working to protect the very industry it is charged with investigating. The result -- a set of regulations that make it impossible for most fair housing groups to use the Program. In the first place, the regulations were designed to require all recipients of the funds to test in only one way. The test requires sending a pair of testers, for example, one white and another minority back to the very same agent at the same office of a realtor. This process is designed not to produce fair tests, but to provide a clear warning signal to the realtor that he or she is being tested. This means of testing is not required

by the courts. Indeed, fair housing lawyers who engage only in this method may well be liable to malpractice cases from their clients.

The Fair Housing regulations forbid groups that have tested a realtor from soliciting that realtor for training funds. Realtors are a sound and common source of funds for the fair housing training programs. This prohibition insures that fair housing groups cannot engage in training. The vast majority of Fair Housing Initiatives Program are allocated funds to the real estate industry for training and education. This is not what the program was intended to do. The effect is to eliminate fair housing groups from training and to insure that all monitoring of the real estate industry is controlled by the real estate industry.

The protection these regulations afford the real estate industry may constitute a conflict of interest. Fair housing groups have been eager to work with Secretary Kemp, as they believe him to be an advocate for fair housing. However, these regulations may so provoke fair housing groups that they will be forced to file suit against these regulations. Some members of Congress are also poised to intervene in the implementation of these regulations. This would not get the fair housing efforts of Secretary Kemp off to a good start.

Finally, the most disappointing part of all the related fair housing regulations is that HUD has never issued substantive fair housing regulations. The Fair Housing Act empowers HUD to issue substantive regulations related to all the members of the real estate industry (appraisers, lenders, realtors, hazard insurance companies, mortgage insurance companies, mortgage service companies, and members of the secondary mortgage markets). In 1979, HUD hired Warren Dennis, former Justice Department attorney and expert in fair lending who had successfully sued the appraisers and lenders over discriminatory appraisal and underwriting practices in 1978. He provided HUD with a detailed analysis of its powers under the Fair Housing Act and a range of choices about approaches to issuing substantive regulations. But nothing was done. Even with Congress' strengthening of the Fair Housing Act, HUD has yet to act.

C. CONCLUSION AND RECOMMENDATIONS

While NPA and other community groups have taken over the enforcement of the Community Reinvestment Act and negotiated billions of dollars in successful reinvestment programs, HUD has failed to develop substantive regulations for lenders under the Fair Housing Act. Now the Department of Justice is investigating cases of lending discrimination in Atlanta, as a result of newspaper articles and actions of NPA-affiliate organizations there. HUD has done nothing but hide its own data on FHA lending and terminate the programs to train local officials in

investigating discrimination in lending.

We make the following recommendations.

1. HUD should disclose its comparable Home Mortgage Disclosure Act data for all FHA lending. In addition, HUD should develop a process for the disclosure of all VA and FmHA loans.
2. HUD should require the analysis of HMDA or comparable data as part of the Fair Housing Plan of Community Development Block Grant recipients.

3. HUD should engage in training programs to assist local governments, and other non-profit and community organizations in the use of disclosure data.

4. As part of the training process, HUD's Office of Policy Development and Research should renew its efforts to develop training guides and various programs and technical assistance packages for the analysis of lending markets. The National Training and Information Center was twice a contractor for studying disclosure data uses and developing a guidebook for using the HMDA data. NTIC worked with Jane Karadbil, one of the fine people still at HUD, in the development of this guidebook. The guide needs revision in light of newer techniques and in order to place the work in

the context of the many Community Reinvestment Act activities of the past few years. Moreover, guides and systems need to be developed for more efficient use of computerized data by local agencies and community groups. NTIC can assemble the team of experts, from community organizations to academics, with the widest range of experience in these areas.

5. HUD needs to revise the Fair Housing Act regulations to deal with the problem of state laws and state agencies that do not provide enforcement equivalent to HUD standards and procedures.

6. HUD needs to change the regulations of the Fair Housing Initiatives Program to remove the present conflict of interest and arbitrary restrictions placed on fair housing attorneys and fair housing training efforts.

7. HUD needs to develop a continuing public process for monitoring the use of its programs to ensure they are used affirmatively for fair housing. HUD should expand its resorces in this area by developing processes that include community organizations and fair housing groups.

98

IV. FHA SINGLE-FAMILY POLICIES

National People's Action major objection with the proposed liberalization of the FHA single-family program is that it will not provide a sound resource for helping more first-time home buyers afford a home and it will lead to massive levels of foreclosure and abandonment. HUD responded to the urban riots in the 1960s with a well-intended policy aimed at providing a free flow of FHA funds for single-family homes into minority and racially changing communities. However, the policy was not thought through. As a result, the policy actually encouraged redlining by conventional lenders, while providing virtually unlimited funds for realtors engaged in blockbusting. The policy destroyed more communities than the rest of HUD's programs helped. The proposed changes in FHA single-family programs would recreate the mistakes of the past in a new form.

A. BACKGROUND

The Original Role of FHA

The FHA single-family programs were originally designed to support the home building industry during the depression of the 1930s. By developing a mortgage with a long term and a low downpayment, the FHA program made housing affordable for millions of Americans. This program works best for new homes. The low downpayments make it possible for people to buy homes with very few resources. This does not create a great risk if these people

purchase new homes with rising incomes. In a new home, the basic systems can be expected to operate for several years without major repairs or improvements.

Using FHA extensively for people buying older homes can lead to many problems. In older urban areas and towns, the housing often has major systems that will need repairs or improvements in the early years of the mortgage. When people have purchased the home with an FHA loan and used all of their small savings for the downpayment, they have few, if any, resources left when these repairs and improvements are needed. In these communities, the housing values may be stable, but they seldom increase at rates fast enough to provide the recent home owner with enough equity to borrow against for future repair needs. Even where major improvements are not required, rising real estate taxes and energy costs can be enough to put a buyer in default. The burden of these costs has been a major factor in high levels of FHA default and foreclosure.

The Housing Holocaust of the Last Decade

Too many people seem to have forgotten the housing holocaust that resulted from HUD changes in FHA policies in the 1960s. These changes drastically relaxed property and credit underwriting standards. There was a huge demand for home ownership in the minority community because these communities had been redlined and discriminated against by both FHA and the conventional

lenders for decades. In fact, the term "redlining" comes from the old FHA practice of drawing red lines on maps to define areas where FHA would not insure loans. The mere presence of minorities in a community (or even in an adjacent community) was written into professional appraisal and underwriting texts as an indicator of high risk and declining values. It remained in these texts until the 1978 settlement of a lawsuit brought by the Justice Department against the major professional organizations of the home appraisal and lending institutions.

What these redlined communities needed was a free flow of both conventional and FHA/VA financing. But the government ignored conventional redlining and intervened only by providing massive flows of FHA and VA financing -- all 100% insured or guaranteed by FHA or VA.

Minority, racially changing, integrated, and lower-income communities were assigned to this government market. With all the money to be made by using the huge flows of these funds, realtors, lenders and developers used the new policies to exploit the poor and minorities. These funds fueled blockbusting and panic peddling. Unknowing buyers were sold homes with fraudulent appraisals and in need of massive repairs.

In addition to existing homes in older communities, developers built entire subdivisions to take advantage of minority demand.

Many of these homes were built with defects in major systems (one example, a development where the homes were never hooked up to the sewer system). Inspectors and HUD officials were often bribed to approve these subdivisions. This created the same problems of huge maintenance and repair costs that are associated with older homes.

Realtors and lenders doctored applications and income profiles and sold people homes they simply could not afford. Finally, realtors and lenders engaged in fast foreclosures as people ran into difficulty making payments. This accelerated the blight and subsequently abandonment resulting in thousands of people losing homes they could have kept with any reasonable forbearance by the lender. The result -- massive fraud and blight.

Residents of Detroit, Chicago, Cleveland, Boston, New York, Newark, Gary, etc. all watched as this process of exploitation ravaged their communities like a wildfire. This process devastated huge areas of our major cities, leaving a deeply scared path of abandoned, vandalized, and gutted homes. The blight has remained in many cities, FHA created such a stigma of disaster that it is still difficult to get many responsible lenders to use FHA.

HUD had unprecedented levels of foreclosures, reaching its peak in the early 1970s. At times the inventory of HUD single-family

22-940 0 - 90 - 4

homes was over 120,000. Prior to these high rates of foreclosure, HUD managed its inventory by allowing homes to remain occupied after foreclosure and by repairing homes before selling them.

HUD adopted new policies that required all the foreclosed properties to be conveyed vacant to HUD. No other mortgagee would ever consider such a requirement. It is a policy of enforced abandonment, which encourages vandalism and increases the eventual loss to the lender. To make things worse, HUD failed to make repairs before selling the homes. In the final analysis, these policies actualy increased HUD's losses on its inventory by encouraging vandalism and contributing to blight and declining home values in the communities where the homes were located. In many inner-cities, where HUD had inundated once healthy communities with FHA loans, neighborhoods became vast FHA wastelands of near total abandonment.

Counseling

One of the best preventive interventions for the problems of FHA lending has been counseling programs. Two kinds have been effective. First, there is pre-purchase counseling. This helps first-time home buyers understand what is involved in owning a home. It helps them understand what they can afford and what they can expect in costs. It helps them plan their home purchase. Finally, these programs are valuable in areas where

realtors and lenders try to exploit racial fears through their blockbusting and steering in order to resegregate communities for personal profit.

Pre-purchase counseling, in this selective situation, can warn prospective buyers about the practices of steering. It can serve as a means of informing these people of the full range of options about where they might want to move and what types of loans they may wish to use. At the core of pre-purchase counseling is an effort to educate buyers so that the free market actually operates with informed buyers making free choices.

Second, post-purchase counseling has been an effective tool in helping home owners who have fallen behing in their mortgage payments. These programs can help people budget their income better. They can help people negotiate a restructuring of their mortgages when a temporary illness, loss of job or other circumstances beyond their control makes it impossible for them to make full mortgage payments for a period of time. These programs also inform people of their rights under such remedies as the Mortgage Assignment Program. In communities where unscrupulous realtors and lenders have exploited new home buyers, minorities, and racial change through abusing FHA programs, such counseling programs can be critical in avoiding the massive abandonment and blight that accompanies such practices.

93

Here, as in other cases, HUD has a shocking record of behavior. A few examples will make the case. HUD's failure to take full advantage of these programs goes back many years. In the mid-1970s, during the negotiations that created the Mortgage Assignment Program, HUD informed us that it was computerizing its default system. Prior to this time, counseling agencies were rapidly informed of people who were in default on their FHA mortgatges. After HUD's computerization, counseling agencies regularly found that they did not get the names of people in default until well after the foreclosure had taken place.

While this may represent the general ineptness of HUD's management, a meaner spirit was revealed in another example. In 1978, the National Commission on Neighborhoods held a meeting on HUD programs in Washington. We asked an official from the HUD Milwaukee Area Office to participate. This man had taken the initiative to go through files by hand to pick out people in the early stages of default. He was able to get them counseling early. As a result, he saved many homes. Early on he helped these people by getting them in to the Mortgage Assignment Program, a program which HUD had always opposed even in the face of court pressure. His success seemed to be an affront to other HUD officials, and he was transferred to another position.

In the Marquette Park area of Chicago, a suit was filed against HUD for allowing its programs to be used for racial

resegregation, in violation of the Fair Housing Act. HUD settled out of court by creating a pre-purchase counseling program that not only helped people prepare for buying a home, but also insured that they knew of opportunities to purchase in other areas. This program did not deny FHA to any buyer. It simply made prospective buyers in this area aware of their options in the market.

This has been a model program that should have been implemented in other racially changing areas where FHA lending was concentrated. Even from the beginning of this program, HUD has failed to monitor and keep proper records of the program. Now, HUD has proposed to eliminate the program, in spite of HUD's failure to cite data indicating the program's ineffectiveness. HUD is proposing to replace the program with a post-purchase counseling program, modeled after a program in Pittsburgh.

The whole purpose of the Marquette Park program was to counsel people before they moved in order to counter the practices of block-busting and steering. Post-purchase counseling cannot possibly deal with this pre-purchase problem.

Meanwhile, in the Austin community of Chicago, where past abuses of FHA lending have caused severe abandonment and blight, residents have been unable to get HUD to implement a post-purchase counseling program to fend off even more foreclosures

and abandonments. HUD's behavior seems to indicate a conscious effort to contribute to the destruction of these communities, rather than an effort to help restore our communities to the health they had prior to being ravaged by realtors and lenders abusing FHA programs for personal gain.

Interventions by NPA and NTIC

National People's Action grew out of a community response to these FHA and HUD-financed disasters. Minorities and whites worked together through NPA to rebuild their communities by fostering partnerships with private lenders. NPA has worked for FHA reforms in order to insure fair access for all people.

NPA developed many programs and policies, some of them with the cooperation of HUD, but others the result of lawsuits against HUD, to help people keep their homes. Several years ago, NPA was able to help reduce the inventory of HUD-held FHA homes to less than 10,000 units. These programs included the creation (by court order) of the Mortgage Assignment Program, which requirs HUD to acquire and restructure the mortgage for home owners who were not given reasonable forbearance by their FHA lenders. This has saved tens of thousands of homes. Other court actions resulted in agreements with HUD to reapir and replace homes for people who were fraudulently sold homes in need of major repairs (the 518(a) and 518(b) programs). Other programs created community marketing and reapir programs to fix up and resell HUD-

held properties. For example, working in partnership with Aetna Insurance Company and initially with HUD also, NTIC developed a series of specific programs to purchase, rehabilitate and resell homes in communities all across the country.

But most of all, through the campaign for reinvestment by banks and savings institutions and through such legislation as the Home Mortgage Disclosure Act and the Community Reinvestment Act, NPA and other community groups have shaped policies and formed partnerships to get conventional lending back into minority, inner-city, and lower-income communities. These efforts have resulted in well over $5 billion in conventional lending commitments nationally.

When lenders complained that they could not get insurance and when they complained that these loans could not be sold in the secondary markets, NPA and NTIC led the efforts to change the policies of the secondary market and the private mortgage insurance companies as well. NPA and NTIC have initiated a virtual restructuring of the secondary mortgage market and private mortgage insurance industry practices. All these efforts have been taken to insure that all of our communities have housing markets that are supported by a free flow of credit from private markets.

B. THE PRESENT SITUATION

The Return of Old Problems

As a result of years of neglect at HUD, the old FHA problems have returned. People are again finding that they have been sold homes in need of major repairs. Today we see the reappearance of new areas of blight. As it is, we have not been able to recover from the original devastation of FHA policies. Many cities, like Detroit, Chicago, Milwaukee, Buffalo, and Cleveland are still trying to recover from the destruction of these earlier FHA policies. For example, the Austin community of Chicago, has an eight block area with 300 abandoned FHA homes. In Milwaukee, realtors engaging in fraud, have left several hundred abandoned homes concentrated in a few inner-city neighborhoods.

NPA cannot stand by and allow the report of the National Housing Task Force or any bill from Congress to sentence our communities to the ravages of high-risk, government-sector housing markets again. If properly administrated, FHA and VA loans are valuable resources for many people, but they should never be allowed to replace the private market. A community cannot grow and prosper unless it is served also by the private financial markets.

FHA's Fiscal Health

The proposal to use FHA-ARMs for poor people would repeat the mistakes of the past and lead to another round of massive blight. The FHA programs are already in trouble financially. We

understand that HUD has about 80,000 foreclosed properties in its single-family inventory right now, with less than a third of these from the general economic problems of Texas, Oklahoma and Colorado. The insurance fund has been depleted to about half its value of just a few years ago. The April 24, 1989 issue of Barron's reported that FHA showed a budget loss for the first time in 1987. It goes on to indicate that the loans in 1988 increased several fold, with severe losses from the insurance fund.

Additional waves of foreclosures would endanger the insurance fund and could create actual claims against the Treasury. HUD is already the largest slum landlord in the nation and would suffer losses that could be even greater than the losses of the 1970s.

C. THE PROPOSALS TO CHANGE FHA SINGLE-FAMILY INSURANCE PROGRAMS

Impact on Moderate- and Lower-Income Buyers

The present proposal is to liberalize FHA and further reduce the downpayments to 3% for up to about $300,000, as opposed to the present program, which provides for a 3% downpayment up to the first $25,000 and a 5% downpayment for the remaining mortgage amount, up to the maximum of $100,000. First, these downpayments represent no change for those buying homes with mortgages under $50,000. For those buying homes with larger mortgages, it allows lower-income people to purchase with even fewer existing resources. Realtors seek to sell homes at the highest levels and

maximum profits. The proposed changes will move lower-income people into even larger and more expensive older homes with even greater potential repair costs.

Second, the new proposals would expand the use of Adjustable Rate Mortgages (ARMs). These are mortgage instruments designed for people with existed rising incomes. Without the expectation of a rising income, increases in the mortgage interest rate could produce housing costs that are more than the home buyer can afford. These mortgages were never intended to be used for people with stable or moderately fluctuating incomes. When combined with low downpayments, these mortgages will have a devastating effect on moderate- and lower-income people who will most likely find themselves with the twin problems of rising mortgage rate and depleted reserves for necessary system repairs. Presently, ARMs are being used in the conventional market for upscale home buyers. Yet, even in this market, these mortgages have high rates of foreclosure. For all categories, ARMs have default rates about twice those for fixed-rate mortgages with the same downpayments. Loans with 5% downpayments (larter than is proposed for the new FHA program) have default rates about twice that of any other levels of downpayment. ARMs with 5% downpayments have the highest default and foreclosure rate of any type of mortgage. Even with large downpayments, ARMs never show a lower default rate than fixed-rate mortgages.

The proposed liberalization of FHA would take all the features of the most risky conventional mortgages used primarily for newer homes in upscale communities with rapidly rising home values and apply them to moderate- and lower-income people living in modest, older communities with stable housing values. These proposals do nothing to attack the basic question of affordability. They allow realtors to make more sales and developers to build more homes for people who will ultimately not be able to afford to make the payments. This benefits the realtors and developers at the expense of our communities and our neighbors.

Impact on Higher-Income Buyers

These changes do very little to assist people in high housing cost areas to purchase homes that they can afford. Conventional mortgages already provide for 5% downpayments and adjustable rates. The proposed new mortgage limits for FHA would be about $300,000 (up from a limit of $100,000). For example, on a $200,000 home, an existing conventional 5% downpayment would be $10,000. The mortgage would be $190,000. With an existing, conventional ARM, the initial interest rate would be around 9%. With a 30 year term, this would require an initial payment of $1,529 per month for principle and interest. A person would have to have an income of about $75,000 to qualify for such a mortgage under present debt ratio standards. This person would have an income of about twice the national median family income. Such a person would only need to save about one and one half month's

salary to reach the present 5% downpayment requirement. In a nation where we need to encourage savings as one of the means of protecting our economy and lowering interest rates, this proposal fails dismally. Lowering the downpayment to 3% only reduces the downpayment by $4,000, or two-thirds of a month's salary.

These proposed changes in FHA discourage savings encourage instant gratification among an income group that could most easily save enough to qualify for an existing, conventional mortgages. It is the role and priority of the Federal government to assist young people in the highest income groups to buy homes in the highest fraction of home values?

More importantly, is it the role of the Federal government to supply this assistance to the wealthy and near-wealthy at the expense of our existing older and urban communities? However well intended, this repeats the mistakes of the past, with much less nobler goals.

The Limits of HUD and FHA

FHA has provided valuable resources for many lower-income and minority home buyers. But efforts to use FHA financing to cure racial discrimination and to meet all the needs of lower income home buyers in the late 1960s resulted in hundreds of thousands of foreclosed and abandoned homes, fraud in sales, exploitation of minorities and the poor, huge financial loses to HUD and the

Federal government, and blighted neighborhoods in city after city where lower-income people and minorities had tried to fulfill the promise of home ownership. A our experience shows, you cannot replace the private market with a government market and expect communities to remain healthy.

You will not be able to convince people that the increased risks and threats of these changes in FHA plicies will be resolved by better management at HUD. HUD has fought all efforts at reform and sound management of its programs. For example, HUD resistance of the Mortgage Assisgnment Program has required the refiling of the original case that created the Program (Ferrell v. Romney). This case has been refiled often as a contempt of court case against every Secretary of HUD up to the present administration. HUD has fought this program from the beginning, even though it has saved thousands of homes and saved HUD from huge losses in its inventory.

D. RECOMMENDATIONS

1. We recommend above all else that HUD adopt an overall policy to DO NO HARM! This should be a guiding principle in all HUD interventions. At least work with us to insure that the new programs and policies of HUD do not make things worse for our communities. We can work with people who have different ideas about how to reach goals that we share. But we cannot tolerate

actions that reward years of our creative and productive efforts by adding new problems to our communities.

2. As a second overall principle we recommend NO QUICK FIXES! Many of the things that hurt our communities resulted from some HUD or Congressional effort to apply a quick fix to a crisis. People who really care about the housing problems must be in it for the long haul. Long-term solutions are not easy and they take some courage and patience.

3. We recommend that you oppose the liberalization of FHA as it is now proposed. These proposals are prime reflections of the quick fix mentality. They do not address real affordability and they will surely wreak havoc on our communities. It may be that in some carefully selected parts of a few metropolitan areas where prices are extremely high in relation to income, that there could be temporary adjustments to the existing FHA ceilings. But there is no reason to make national changes just because there are extreme prices in a few places like Washington, Boston, San Francisco and New York.

4. We recommend the principles of the HOME program that we

have included for your review as a comprehensive and instructive intervention to make home affordable to those with the least ability to afford them. This program begins with an incentive for encouraging savings prior to home ownership. It insures that people will be able to afford a home by its use of HOME savings certificates and by its use of fixed-rate mortgages. It has the support of the private lending and insurance industries.

5. We propose that HUD change its policies of vacant delivery of foreclosed homes and renew its policy to repair the home in its inventory before resale. At least, HUD should work through local non-profits to rehabilitate and resell the homes in its inventory. Over the years, we have built up a tremendous capacity to undertake these activities.

6. We recommend that HUD adopt a two-fold policy on counseling programs. While we do not feel that all FHA home buyers should be required to have counseling, we do recommend the use of pre-purchase counseling in communities which are subject to racial resegregation or high concentrations of FHA lending. We also recommend a program of post-purchase counseling in areas with high rates of FHA defaults and foreclosures. First, HUD

must learn to monitor both the location and volume of FHA sales and the location and volume of defaults and foreclosures. In census tracts where HUD has levels of sales of levels of defaults and foreclosures twice the average for all tracts, HUD should require the appropriate pre-purchase or post-purchase programs.

7. We recommend that HUD operate the Mortgage Assignment Program properly and cease in its efforts to undermine the program and its goals.

8. We recommend that HUD monitor the use of its FHA programs and take seriously its obligations to withdraw certification for FHA programs from lenders who engage in abusive and destructive practices. HUD's failure to take punitive action against lenders engaged in racial resegregation and the sale of defective homes encourages the continuance of these practices. The resulting foreclosures costs HUD dearly in losses on its inventory. HUD must learn to protect the home buyers and not the mortgage banking industry.

9. HUD should comply with the Home Mortgage Disclosure Act and release data on the locations and FHA loans. (This recommendation is repeated in the section on Fair Housing, where there is a full discussion of this problem).

V. HUD'S RESPONSIBILITY TO THE PUBLIC HOUSING SECTOR

National People's Action recognizes the critical importance of maintaining a ongoing supply of housing for very low-income people. Poor maintenance in public housing is a direct cause of abandonment and loss of a once viable housing stock. Many families cannot live in public housing because of the unsafe and unsanitary living conditions. The Federal government and HUD must recognize their responsibility for this stock of housing and, as such, make funds available for the ongoing maintenance and repair of our nation's public housing stock.

Federal Government Withdrawal from Public Housing

NPA takes exception with recommendations to sell off or "privatize" public housing. The main problem with the privatization of public housing is that it seriously depletes an entire sector of housing -- "housing of last resort." As a nation we need a dependable and constant supply of housing that is available to very low-income people. We must recognize that there is a continued need for this type of housing, and that the private market is incapable of providing housing for those with very little financial means.

Tenant ownership will only succeed in shifting the financial responsibility from the Federal government to people who can not afford the costs of owning and repairing the housing. In many

cases, this housing has been badly neglected for years by the public housing authorities and the Federal government. The estimated backlog of mandatory modernization need of public housing properties across the nation ranges from $ 7.5 to $ 9.2 billion (HUD Perspective on Public Housing Modernization, U.S. Department of HUD, March 1988). This reflects the amount needed to make the necessary repairs in public housing to bring it up to acceptable living standards.

The need to preserve a minimum threshold of very low-cost housing is absolutely essential given the inability of the market to serve the housing needs of very low-income people. The Federal government is the only sector that has the financial capability to maintain a stock of "last resort" housing.

The Loss of Public Housing

Another concern of NPA is the demolition of public housing without a guaranteed "one for one" replacement of all units lost. HUD's present policy only requires the replacement of currently occupied units. There is no requirement for a replacement of vacant units. Many times a building will be demolished and the unoccupied units will be permanently lost.

NPA takes issue with the administration of the Comprehensive Improvement Assistance Program. In some cities, CIAP monies are being used for demolition when these funds should be used for

capital repairs and improvements. This is contrary to the intended purpose of the program.

RECOMMENDATIONS

1) HUD should recognize the critical role it has in administering the public housing program. Federal subsidies should be made available to maintain and repair the public housing stock. This stock must be sustained as a last resort for those with the least financial means in this country.

2) There should be one for one replacement of all public housing units demolished, including occupied as well as vacant units.

3) CIAP monies should be used for repairs and ongoing maintenance in order to guarantee safe, sanitary and quality housing. In addition, HUD should clarify the process and application procedures for the CIAP.

4) Community control of public housing should be encouraged through resident management programs where applicable, keeping in mind the larger front end costs of this type of venture, but with large potential savings in the long run. This is not the same as resident buyouts.

5) HUD should provide a uniform interpretation of all HUD public housing regulations and procedures throughout all the local HUD regions.

VI. LOSS OF SUBSIDIZED HOUSING

National People's Action is very concerned about early prepayment of the mortgages on privately owned, federally subsidized buildings and the expiration of Setion 8 contracts. The existing inventory of privately owned, assisted rental housing for low- and moderate-income people is nearly 3 million units. There are three main problems that threaten this inventory of low-income housing: 1) mortgage prepayment, 2) subsidy expiration, and 3) poor physical condition (National Housing Preservation Task Force). Tens of thousands of people are at risk of being dislocated if actions are not promptly taken.

We should not waste the billions of federal dolars that have gone into creating the more than 3 million subsidized housing units over the last 50 years.

NPA strongly believes that HUD and the Federal government have a responsibility for mitigating the impacts of this pending crisis on low-income tenants. NPA's recommendations are the following:

RECOMMENDATIONS

1) Inform tenants. Tenants have a right to know about the possibility of their building being converted into market rate housing through Prepayment or Section 8 Opt.

as well as financial crisis and imminent foreclosure. This information should be released to tenants at the earliest possible date, a 2 year notice would be reasonable.

2) Provide assistance for tenant purchase. As a last resort, the Federal government and HUD should assist tenants who want to purchase their buildings. HUD should provide low-interest loans to tenant groups for the balance owed on their building's mortgages. This could be done under the 236 and 221d3 programs. In addition, HUD should continue subsidizing the rents of low-income tenants for the life of the mortgage.

3) Support current law on building conversion. HUD should support an extension of the two year moratorium on the market rate conversion of subsidized buildings until an equitable and long-range solution is reached.

4) Limit the windfall to private developers who choose to convert their buildings. Private developers have already benefited considerably through these federal subsidy programs. It is not fair to allow those who have gained so much already to continue to reap tremendous profits at the expense of low-income tenants who stand to lose the most.

VII. EXPANDING THE LOW-INCOME HOUSING TAX CREDIT

National People's Action strongly supports the preservation and the expansion of the low-income housing tax credit. It is one of the few remaining incentives for investment in low-income housing development. Many of NPA's member neighborhood housing developers syndicate their low-income housing tax credit. It must be preserved and expanded. NPA has made some recommendations for the expansion of the low-income housing tax credit.

RECOMMENDATIONS

1) HUD should support imposed limits on the ability of owners to transfer or convert property benefitting from the low-income housing tax credit. This should be done to help ensure that the property remains low-income for a period longer than 15 years, as required by current law.

2) HUD should support the extension of the type of developments that are permitted under the low-income housing tax credit. Only rental developments are currently allowed. Serious consideration should be given to tenant ownership and cooperative venture.

3) HUD should support flexibility in the low-income housing tax credit local community's housing needs.

NATIONAL PEOPLE'S ACTION

APPENDIX A

NEIGHBORHOODS *First*

HOME OWNERSHIP MADE EASIER (HOME) PROGRAM

Today there are two fundamental problems facing low to moderate income first time homebuyers — accumulating a downpayment and making the monthly mortgage payment. The Federal government has a role to play in alleviating these affordability problems. However, any solution must involve a partnership between the public and private sector and must have a negligible impact on the Federal budget.

To achieve these goals, we propose the Home Ownership Made Easier Program or HOME Program. The HOME Program would combine both Federal and private resources to put people into homes. Equally important, it would require potential homeowners to work toward and save for their homes. It is structured so the homebuyer would have equity in the property and achieve the dream of homeownership in a shorter, more realistic period of time than is currently possible.

Under the HOME Program, eligible first time homebuyers would be able to deposit funds in special savings certificates and these personal funds in turn would be matched by the Federal government. The amount of Federal matching funds would depend on the homebuyer's income. The participants would be able to use these funds for expenses associated with a mortgage loan, including the downpayment, closing costs or to buydown the interest rate. The homeowner would repay the Federal government the funds it contributed to the certificate. A secondary market would be established for some of these loans.

The following are the specific aspects of the HOME Program:

1. *First time homebuyers (anyone who has not owned a home in the last three years) would be able to contribute to "HOME Certificates" by depositing funds into a depository institution which would act as the agent for the Federal government. The funds would be administered by the Department of Housing and Urban Development.*

2. *The Federal government would contribute to the certificates in an amount dependent on the income of the first time homebuyer. The following illustrates how the Federal contributions would work:*

% Median Household Income*	Borrowers Contribution	Government Matching Share Per $1.00 Contribution	Total HOME Certificate Amount
≤ -50%	$1.00	$4.00	$5.00
51–80%	$1.00	$3.00	$4.00
81–100%	$1.00	$2.00	$3.00
101–120%	$1.00	$1.50	$2.50
Over 120%	Not Eligible		

* Median income tables would be made available through the Department of Housing and Urban Development.

First time homebuyers with incomes above 120 percent of the area's median income would not be eligible for this program.

3. *If a first time homebuyer's income were to go above 120 percent of the area's median income, he or she would no longer be able to participate in the program. However, they would be able to use the existing personal and Federal funds in the certificates to purchase a home subject to all the conditions of the program.*

4. *Borrowers would receive five percent interest on the money contributed to the certificates.*

5. *The total amount that the borrower would be able to contribute to a certificate in any one year is five percent of his or her income. The total amount of the certificate, including the government's contribution, could not exceed 50 percent of the area's median income. To help first time homebuyers immediately after the program begins, the requirement of five percent of income per year could be phased in over three years. In year one, a first time homebuyer could contribute up to 15 percent of his or her income; in year two, ten percent; and year three and from then on five percent. The 50 percent of median income cap, however, would still apply.*

6. *The government's contribution to the borrower's certificate would vest depending on the length of time the borrower is in the program. If the borrower decides to purchase a house after being in the program only one year, he or she would only receive 25 percent of the government's matching fund; after two years 50 percent; and after three years or more, the full amount of the government's matching contribution.*

7. *Borrowers would be required to purchase their home within seven years of making their first contribution to a certificate. If borrowers withdraw from the program without purchasing a home, they would receive only the funds they contributed, plus the interest. They would not receive the government's matching funds.*

8. *A home purchase certificate would be issued to eligible participants at the time they purchase their home in an amount equal to the participant's contribution, plus the government's matching share. The participants would receive a statement at the end of each year stating the amount they contributed and the amount of the Federal match for that year, based on their income for the year.*

9. *The borrower could use the certificate to purchase any home using either conventional or Federally insured or guaranteed financing. The certificate would be used for expenses associated with a mortgage loan. The borrower would simply present the certificate to the lender at closing and the lender in turn would redeem it for its face amount.*

10. *The maximum loan to value ratio for a loan using funds from this program would be 95 percent.*

11. *The Federal government would receive a second lien on the property for an amount equal to its contribution to the certificate.*

12. *Borrowers would be required to pay back the amount contributed to their certificates by the Federal government. Payments to the government would begin immediately after the home is purchased. Borrowers earning less than 80 percent of the area's median income at the time they purchase their home would pay three percent interest on the second lien, amortized over the life of the first lien. Borrowers earning between 80 and 120 percent of median income would pay nine percent.*

13. *A secondary market for the second mortgages to purchasers earning between 80 and 120 percent of median income would be established.*

14. *If the borrower sold the property, the amount owed to the government would be due in full. If the proceeds from the sale of the house were insufficient to pay back the government then the unpaid balance would be considered an unsecured obligation of the borrower.*

15. *The servicer for the first lien also would service the second lien for the government. The servicer would receive a 50 basis points servicing fee, which would be taken out of the interest rate paid by the borrower.*

16. *The program would sunset four years after it is started. This means that potential homeowners would have to begin to make their contributions before the four years expires in order to be eligible to receive government matching funds when they purchase a home.*

The vital element of the HOME Program is that it focuses on borrower income and those in our society with the greatest need. It will not help high income individuals or those seeking to trade up from one house to another. The focus is not on house prices. The program stretches further by as much as 11 to 26 percent the capacity of a household with a modest income to qualify for homeownership. The HOME Program requires action by the potential homebuyer, service by the private institution, and commitment by the government.

In addition, the HOME Program has minimal impact on the Federal budget. Monies are constantly flowing into the program in the form of contributions by potential homeowners, sales of the second mortgages on the secondary market, and repayment of second mortgage loans. The HOME Program is projected to ultimately make money for the government. It will have a net negative cash flow for only four years and then the cash flow will be positive. By the time the program sunsets, it will have helped 500,000 deserving families purchase homes. The program is an efficient way to leverage Federal funds.

HOME PROGRAM

ANNUAL CERTIFICATE VALUE AND MORTGAGE IMPACT

EST. U.S.A. MEDIAN INCOME

		BORROWER INCOME			
MEDIAN INCOME	% OF MEDIAN	MAXIMUM ACTUAL INCOME	MAXIMUM ANNUAL CONTRIBUTION	GOVERNMENT MATCHING CONTRIBUTION	ANNUAL CERTIFICATE TOTAL
$28,800.00	50%	$14,400	$ 720.00	$2,880.00	$3,600.00
	100%	28,800	1,440.00	2,880.00	4,320.00
	120%	34,560	1,728.00	2,592.00	4,320.00

Assumptions:

1) For each dollar saved by the first-time buyer, the government will make contributions according to the following schedule:

% OF MEDIAN	$ MATCHED PER $ SAVED
50%	$4.00
100%	2.00
120%	1.50

2) First-time buyer saves for a 3 year period.
3) 30 Year Fixed Rate Instrument
4) 10.5% Interest Rate
5) 5% Downpayment
6) Housing Ratio of 28% (80% of the maximum PITI payment represents principle and interest. The remaining 20% is allocated to taxes and insurance.)
7) Each 6% of the first lien will permanently buydown the interest rate 1%.
8) Interest rate applicable to the second mortgage:

% OF MEDIAN	% INTEREST
50%	3.0%
100%	9.0%
120%	9.0%

The second mortgage is amortized over a 30 year term.

HOME PROGRAM

Comparison of Payments

	Low Inc. Group (at or below 80%)	Moderate Inc. Group (81%-120% of Med.)
Amount Saved (incl Interest)	$ 3,832	$ 5,748
Govt Matching	10,683	8,012
Total Available	$14,515	$13,760
Purchase Price	$50,000	$70,000
First Mortgage (1)	36,817	58,488
Second Mortgage (2)	10,683	8,012
Combined LTV	95	95
Payment on First	337	535
Payment on Second	45	64
Monthly Income (3)	$ 2,037	$ 3,055
Combined P&I Pct	18.7	19.6

(1) 30-year loan at 10.5% for both groups
(2) 30-year loan at 3% for low income group;
30-year loan at 9% for moderate income group
(3) Low income group at 80% of median;
Moderate income group at 120% of median

HOME PROGRAM

Federal Budget Impact Analysis
4-Year Program

No. of Buyers	500,000
Net Govt. Cash Flows	($Millions)
Year 1	121
2	140
3	(221)
4	(245)
5	(548)
6	(657)
7	92
:	
Total	(218)

PROPOSED HOME PROGRAM ANALYSIS
ESTIMATED BUDGETARY IMPACT FOR GOVERNMENT
($ Millions)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	201
CONSOLIDATED CASH FLOWS																						
Outflows :																						
Req'd Funding	0	0	364	624	1015	1163	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Int to Individ	3	12	18	22	20	8	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
HOME Withdraws	84	284	634	592	541	447	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Servicing Fees	0	0	2	5	9	13	14	13	12	11	10	9	8	7	6	6	5	5	4	4	3	3
TOTAL	88	296	1018	1243	1585	1631	14	13	12	11	10	9	8	7	6	6	5	5	4	4	3	3
Inflows :							37	35	32	29	26	23	21	19	17	15	13	12	11	9	8	7
Int Income 2ND	0	0	2	9	18	28	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Int on Excess $	5	12	8	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Seendry Mkt Sls	16	69	328	390	457	459	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
HOME Contrib	188	354	460	592	541	447	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Principal Repay	0	0	0	6	21	40	69	87	92	93	91	81	74	68	57	52	46	43	41	38	36	33
TOTAL	209	436	797	998	1037	974	107	122	124	122	117	104	95	87	74	67	59	55	51	48	44	40
Net Cash Flow	121	140	-221	-245	-548	-657	92	108	112	111	106	95	87	79	67	61	54	50	47	44	41	38
Cum Cash Flow	121	261	40	-205	-754	-1410	-1318	-1210	-1098	-987	-881	-786	-699	-619	-552	-492	-438	-387	-340	-296	-255	-218

NTIC National Training and Information Center
810 N. Milwaukee Ave. □ Chicago, Illinois 60622-4103 □ (312) 243-3035

APPENDIX B

NATIONAL HOUSING TRUST FUND PROPOSAL, March 1989

The National Training and Information Center (NTIC) proposes the creation of a National Housing Trust Fund to provide housing for low- and moderate-income Americans.

The National Housing Trust Fund should not be viewed as the exclusive solution for solving our nation's housing problems. Public housing and federal rental assistance programs should not be included in this fund. These programs require the federal government's on-going budget commitment.

The National Housing Trust Fund is a new source of funding and would be self-financing. Therefore, it would not affect the federal budget deficit in any way. Funding sources for the National Housing Trust Fund (NTF) have already been identified. The funding would come from the housing industry through housing-related user fees.

DEFINITION AND PURPOSE

The NTF is a government account, such as the Highway Trust Fund, capitalized by a dedicated, self-financing source of revenue.

The NTF would be used for the construction and rehabilitation of multi-family rental and single-family units for permanent occupancy by low- and moderate-income singles and households. The funds would be issued in the form of a one-time capital grant to non-profit and for-profit developers with strict resale limitations on the units built.

The NTF would be a flexible fund used for a variety of purposes, including land purchases, construction subsidies, interest rate buy-downs, and mortgage insurance.

The NTF would not replace current government and private sector investment. Rather, it would complement the current housing initiatives and work in partnership with the local government, community and private sectors.

ALTERNATIVE REVENUE MEASURES

NTIC recommends the NTF to be initially funded at $20 billion per year. 15% of the fund will be raised through local sources. The remaining 85%, or $17 billion, will not come from general tax revenue, but will be raised from the following housing-related sources:

0.5% Universal Fee on Residential Real Estate Transfers
NTIC proposes a national real estate transfer fee to be charged on the exchange of all residential properties, single and multi-family. This fee would be paid for by the buyer. A 0.5% fee on each $1000 of property value transferred would yield approximately $2.5 billion annually. If multi-family sales were included, the revenue raised would be even greater. These revenues would fluctuate yearly depending on the activity of the housing market.

1% Fee on Mortgage-Backed Securities
It is estimated that in 1986 $180 billion worth of mortgage-backed securities were either sold or swapped by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and private mortgage-backed security issuers. NTIC proposes a 1% fee on the issuance of mortgage-backed securities. This would yield annual revenues of $1.8 billion.

15% of Homeowners Interest Deduction of Highest Priced Homes
90% of all federal housing tax expenditures are obtained from mortgage interest deductions, property tax deductions, and capital gains tax deferrals. The distribution of federal housing tax and budget expenditures has become significantly more regressive. For instance, the federal budget authority in 1981 for housing totalled $26 billion and fell to $10 billion by 1989. In this same time period, federal housing tax expenditures rose substantially from $33 billion in 1981 to $53 in 1989. NTIC recommends a move to recapture some of these federal housing tax expenditures from the most affluent homeowners. By transferring 15% of total housing-related tax expenditures, approximately $5.2 billion could be raised on an annual basis.

5% Contribution from the S&L Bailout
A nickel out of each dollar spent on the bailout of the savings and loan industry should be earmarked for the NTF. The public deserves some payback from the failure of some S&Ls to fulfill their original purpose: to provide home loans in neighborhoods. This 5% contribution could pay for a significant chunk of the NTF initially. The latest bailout is estimated at $150 billion, thus resulting in $7.5 billion for the NTF.

ADMINISTRATION

The receipts designated as belonging to the NTF would be dedicated by law to a government account known as the "National Housing Trust Fund."

Funding
The following provisions which generate revenue would be placed in the NTF on an annual basis. The S&L contribution would be earmarked immediately and the other revenues would be phased into the NTF over a ten year period.

Targeting
50% of the funds are targeted for very low-income (under 50% of area median household income), 30% of the funds are targeted for low-income (50%-80% of the area median household income), 10% of the funds are targeted for moderate-income (80%-100% of area median income).

Allocation
Local distribution would be structured similarly to the Community Development Block Grant (CDBG) formula, using specific criteria to target the funds to the areas in the country with the greatest needs. This funding criteria would take into account several factors of need: number of household paying over 30% of adjusted income; rental housing vacancy rates; extent of physically inadequate housing; equitable distribution between urban and rural areas.

Grant funds would be divided in three ways to ensure funding accessibility to developers: 60% for metropolitan cities and urban areas; 30% for states; and 10% for direct distribution by HUD. The direct HUD allocation is available for those developers where the city or state is either unwilling or unable to obtain funds.

Project Access
Only those developers who agree to maintain permanent affordability according to the targeting requirements will have access to these funds. Recapture requirements will be placed on the resale of units subsidized by the HTF, with strict penalties imposed on any sale that affects affordability.

Matching Requirements from Local Sources
Local governments are encouraged to maximize their capital resources for housing low-income residents. A 10% match requirement would help leverage greater investment in low- and moderate-income housing. Eligible local matches include capital grants, interest rate write-downs, land donations, tax abatements.

Implementation
The HTF would be administered through the Department of Housing and Urban Development (HUD). A ten-year sunset clause would go into effect to determine if there is a future need for this funding.

CURRENT FEDERAL HOUSING PROGRAMS

The HTF should not by any means serve as a replacement for the on-going budget commitments of the federal government.

Public Housing
Public Housing needs its own program funding support on a continued basis. The mandatory modernization need for public housing alone in this country is estimated between $7.5 and $9.2 billion. This figure represents the unfunded backlog of modernization work required to bring all public housing projects up to HUD's mandatory standards.

Categorical Housing Programs
The major portion of the current HUD 1989 budget, $7.5 billion, is directed to categorical housing programs including vouchers, Section-8, new public housing construction, and Section 202/Elderly and Handicapped. Rental assistance and public housing require federal budget support of their own.

THE GOAL OF NTIC

There are many forces at work eroding the supply of decent and affordable housing for low-income Americans, including undermaintenance and privatization of public housing, prepayment of federally subsidized mortgages, redlining, deterioration and abandonment, and gentrification and displacement.

Housing should not be regarded for its economic value alone. Housing has an important social purpose to serve in our society. A new National Housing Policy must recognize and work towards this.

Every individual needs a safe and decent house in which to live. The HTF proposal is a first step to elevating housing to the status it deserves through the creation of a special fund dedicated to providing housing for each and every American citizen. NTIC is dedicated to ensuring that the right steps are taken in National Housing Policy towards providing affordable, decent and safe housing for every citizen.

APPENDIX C

NATIONAL PEOPLE'S ACTION

NEIGHBORHOODS *First*

April 11, 1989

Don Campbell
Staff Director
Senate Housing Subcommittee
535 Dirksen Senate Building
Washington, D.C. 20510

Dear Don:

Thanks for arranging our meeting yesterday with Senator Cranston. I wanted to follow up by summarizing our major concerns about the Senator's proposal to expand and liberalize the FHA:

1. FHA LIMITS WOULD BE EXPANDED FAR MORE THAN NECESSARY AND INCREASE REDLINING OF LOWER-INCOME AREAS

Expansion of FHA ceilings would provide a further disincentive for FHA lenders to originate low-value, inner-city loans. Senator Cranston has been a strong advocate of anti-redlining laws. Yet mortgage brokers that can utilize FHA on homes costing $150,000 or more will have greater incentive to redline low-value homes in many urban areas.

If increases in FHA limits to serve first-time buyers in high-cost markets are needed, they should be targeted to the types of homes these buyers are in fact likely to purchase. NPA views an expansion of FHA to 95 % of local median home price as far too extravagant. Few first-time homebuyers start in the middle of the housing market --- nor should federal housing policy enable them to.

Nationally, the Realtors report that in 1988 the median-priced, first-time home cost $75,000, less than 85 % of the $89,000 price of the median-priced home. In Los Angeles, Chicago Title and Trust's 13th Annual Survey reports the median-priced, first home costs $137,500, compared to $191,200 for the median-priced home. FHA doesn't need to address itself to households buying $190,000 homes when the typical starter home even in Los Angeles costs far less.

2. THE FHA EXPANSION PROPOSAL DOESN'T INCREASE THE AFFORDABILITY OF A FIRST-TIME HOME

The FHA expansion proposal assumes that the major reason younger families can't afford a first-home is the downpayment. It would allow first-time buyers to put three percent down on the entire home amount.

In Los Angeles, the expansion would change the eligible home price ceiling to $181,640. The minimum downpayment on this home would be less than $6,000. At current interest rates, the monthly mortgage payment would be well over $1,800, requiring an annual income of over $75,000 to qualify. A family making $75,000 a year should be able to save far more than $6,000 --- or less than one month's pay --- for a downpayment.

The real affordability problem for buyers of high-cost homes is monthly payment, not downpayment. A family making over $75,000 that can qualify for a $180,000 home should be able to save at least a $9,000 downpayment for a conventional loan. The real problem is that relatively few families can spend that much for housing. The real solution is to lower either interest rates or home prices. To the extent that higher FHA ceilings make it easier to build and finance more expensive homes, the FHA proposal is actually likely to result in higher, rather than lower, home prices, and higher monthly housing expenses.

NPA views FHA's current downpayment structure as sound. Low-income families spend the highest percentage of income for basic needs such as housing, and have the least available income to save for a downpayment. Such families often require a minimum three percent downpayment. The slight increase in risk that would result from increasing the three percent downpayment to the first $50,000 of home value may also be warranted.

3. THE FHA EXPANSION INCREASES FORECLOSURE RISK FOR ALL FAMILIES, PARTICULARLY LOWER-INCOME FAMILIES

By design, FHA is a program for families at the margin of eligibility. That explains why FHA delinquency and default rates are consistently twice as high as those for conventional loans. For example, as of the fourth quarter of 1988, the MBA reported that 6.55 % of FHA loans were delinquent nationwide, compared to 3.06 % of conventional loans. FHA loans with three percent downpayments are a vital part of federal housing policy, but they clearly entail greater risk for those that use them, and therefore should be used as lender of last recourse.

FHA has also proven to be particularly vulnerable to fraud and abuse. The institutions that drive FHA --- the federal

government and national mortgage companies --- are large and bureaucratic enough that abusers can find a niche. 100 percent insurance also makes it easier for FHA lenders to make mistakes that conventional lenders with greater risk would have avoided.

In the 1970's, these and other factors created FHA scandals that made HUD the biggest slum landlord in the country, with an inventory of over 100,000 foreclosed homes. NPA fought to tighten up and clean up FHA, resulting in lower foreclosure rates and smaller inventories of foreclosed homes for much of the 1980's. However, abuses on the magnitude of the 1970's still flare up. The Austin neighborhood on Chicago's West Side is filled with hundreds of vacant FHA-owned homes. Abuse is part of the FHA system, and it needs to be continually controlled.

The proposed expansion of FHA adjustable-rate mortgages would take a mortgage finance system that already has problems and make those problems worse. I've enclosed an excerpt from a Moody's report which documents the risk of adjustable-rate-loans. During periods of stable or decreasing interest rates (such as 1985 and 1986), ARM mortgages perform about the same as fixed-rate loans. However, during periods of increasing interest rates (such as 1980 to 1984), ARMs create tremendous instability in monthly housing payments. As a result, when interest rates increased, adjustable-rate loans had foreclosure rates twice as high as fixed-rate loans for all borrowers. ARMs are even more dangerous for lower-income borrowers that are least likely to have rapid increases in income, or large accumulated savings, that can make ARMs manageable when mortgage payments increase.

Defenders of FHA expansion rebut that ARMs are less risky than before because underwriting of these loans is now more conservative. Specifically, applicants would be qualified at the maximum interest rate an ARM could adjust to after one or two years. For example, an applicant for an 8 percent ARM would qualify only if they could afford monthly payments on a 10 or 12 percent loan. In effect, in order to qualify for an ARM, you'd also have to be able to afford a fixed-rate loan.

This logic is obviously self-defeating. The case for FHA ARMs is that they will lower interest rates, thereby increasing eligibility. However, anyone that could qualify for an ARM using today's standards can also qualify for a slightly more expensive fixed-rate loan. ARMs would expand risk, not eligibility. ARMs would increase initial "affordability," but only by exposing buyers to the risk of rapidly inflating mortgage payments 12 months later. Would the risk be as severe as in the early 1980's? No one honestly knows. However, you should be highly suspicious of anyone that tells you that first-time buyers who can afford no more than a three percent downpayment would somehow be able to afford mortgage payments that could potentially increase by hundreds of dollars a month. Who's kidding who? By definition, any borrower that can't afford more than a three percent downpayment lacks the stability that could make them a good candidate for a riskier adjustable-rate loan.

The reduction of FHA downpayments from five percent to three percent for all first-time homebuyers makes even less sense to us. Why encourage families making $75,000 or more a year to make a downpayment that amounts to one month's pay? This is a policy of instant gratification that may very well backfire. Houston and Denver have provided very good examples of what can happen when upscale, first-time buyers buy overvalued homes with low downpayments, and then a recession occurs. Thousands of "low-risk" borrowers in "appreciating" neighborhoods lost their homes. If 60 % of the nation's economists are right and a national recession occurs soon, a liberalized FHA will invite similar horror stories across the country --- not just in poor urban neighborhoods, but in upscale suburban areas as well.

4. EXPANSION OF FHA IS NOT A COST-EFFECTIVE WAY TO ADDRESS OUR HOUSING AFFORDABILITY PROBLEMS.

Even if the proposed changes in FHA addressed today's real affordability problems, which we think they don't, the cost of these changes would be too high. FHA's reserves are already strained. Further increases in FHA foreclosure rates that would surely result from greater use of ARMs and lower downpayments would only further strain an already weaker financing system.

ALTERNATIVES TO FHA EXPANSION

The proposed changes in FHA would primarily benefit families making $40,000 or more a year which can not afford to buy typical starter homes that cost over $101,250, the current FHA ceiling.

Fortunately, relatively few families suffer from this problem. The FHA high-cost limit exceeded the median price of all homes in 80 percent of all metropolitan areas in 1988. In many areas where the median cost of all homes exceeded FHA limits, the $101,250 ceiling still exceeded the median cost of starter homes. There are relatively few areas of the country where $101,250 won't buy you a decent starter home. We understand much of California is about the most expensive housing market in the country. But even there, any family that can qualify for huge monthly payments on a starter home costing more than $100,000 can surely afford a five percent downpayment upfront. In fact, the only way they are going to be able to afford high monthly payments is by reducing principal balances through a large downpayment. Three percent downpayments on the entire home amounts works counter to this goal.

I agree with Senator Cranston that a comprehensive housing

strategy that can gain broad political support will involve helping yuppies that can't buy homes. My point is that expansion of FHA doesn't really help the yuppies, and it threatens to wreak havoc in urban neighborhoods already eligible for FHA loans.

NPA sees the following actions as steps that would solve the real housing affordability problems of a broad range of families:

1. PROMOTE THE AVAILABILITY OF FIVE PERCENT DOWN CONVENTIONAL LOANS.

NPA has spent two years on an effort that has resulted in liberalization of a broad range of Fannie Mae and private mortgage insurance eligibility guidelines. These changes should make it at least somewhat easier for all first-time homebuyers, including yuppies, to qualify for a five-percent-down conventional loan. However, further changes are needed.

NPA, Fannie Mae, General Electric Mortgage Insurance, and Mortgage Guaranty Insurance Corporation have structured a ten-city demonstration program that will help inform secondary markets and mortgage insurance companies on how to soundly insure and purchase low downpayment mortgages from even the most "marginal" neighborhoods. We're very excited about this initiative. Where secondary mortgage markets and private mortgage insurers have failed to make low downpayment home finance available in the past, we feel they are now taking steps in the right direction that should be further encouraged by the federal government. In California, where modest housing still costs over $100,000, a five percent downpayment is by no means an unreasonable barrier for an upscale family that can qualify.

2. HELP PROMOTE LOWER HOUSING COSTS.

The biggest problem in California, of course, that homes simply cost too much. Making it easy for younger families to purchase expensive homes by using riskier mortgage instruments will simply add to the problem by increasing both the cost of housing and the risk of lending. Instead, creative approaches to lowering the cost of housing are needed. As a national objective, any family should be able to buy a decent first home in a decent neighborhood for less than $100,000.

For our part, National Peoples Action has initiated an effort to form a national demonstration program with the National Association of Home Builders to find better ways to build and rehabilitate less expensive housing. Since we have already formed affordable housing partnerships with lenders, secondary markets, and mortgage insurers, we feel optimistic that such an approach can succeed.

3. ENACT THE HOME PROGRAM DEVELOPED BY NPA AND THE MORTGAGE INSURANCE COMPANIES OF AMERICA

In most areas of the country, families making in excess of 120 percent of local median income can afford to buy, at the very least, the median-priced starter home. The real homeownership affordability gap in most areas of the country is for families making low-, moderate-, or middle-incomes.

The HOME program is designed to help families making 120 percent or less of median income to become first-time homebuyers. Where the proposed FHA bill would further lower already low downpayments, the HOME program would help families to save a five percent downpayment. Where the FHA plan fails to address the problem of affordable monthly housing payments, the HOME program could lower the monthly cost of housing for some families by as much as twenty percent. Where the FHA plan turns to a quick fix using proven dangerous mortgage instruments, the HOME plan uses fixed-rate mortgages that have been proven to be more reliable. Where the FHA plan would increase the level of foreclosures in an already weak financing system, the HOME plan would complement affordable housing partnerships with financial institutions across the country that have proven to be sound and profitable. Finally, where the FHA plan could increase the government's foreclosure expenses by billions of dollars, the HOME program would cost from $200 million to $600 million a year, meeting a recognized need in a fiscally prudent manner.

We recognize that upscale California households are priced out of the housing market. However, we still think promoting savings and larger downpayments is the best approach. Three percent downpayments won't change the fact that a Los Angeles family has to make about $60,000 to qualify for a typical $135,000 starter home. If the federal government could allow these families to get to 20 percent down loans --- either by helping them to save the downpayment or by loaning part of it to them --- income eligibility would drop to $50,000.

I look forward to the opportunity to testify Senator Cranston extended when hearings are held next month. Once again, thanks for addressing our concerns on this matter.

Sincerely,

Gale

Gale Cincotta
Chairperson

cc: Bill Lacy, President, Mortgage Insurance Companies of America
David Maxwell, CEO, Fannie Mae
Shirley Wiseman, President, National Association of Home Builders

1125 Fifteenth Street, N.W.
Washington, D.C. 20005
202-861-6500

Mortgage Bankers Association of America

STATEMENT OF

WILLARD GOURLEY, JR., CMB

VICE CHAIRMAN
BARCLAYSAMERICAN/MORTGAGE CORPORATION
CHARLOTTE, NORTH CAROLINA

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

Roundtable Hearing

on

Homeownership and Affordable Housing With Emphasis on
S 565, the National Affordable Housing Act

June 9, 1989

The Mortgage Bankers Association of America (MBA)* respectfully submits this statement on the issues with respect to homeownership and affordable housing that are addressed in S 565, the "National Affordable Housing Act." My name is Willard Gourley, Jr. and I am Vice Chairman of BarclaysAmerican/Mortgage Corporation, located in Charlotte, North Carolina. I am also serving as MBA's President and I am accompanied today by Burton C. Wood, MBA's Senior Staff Vice President and Legislative Counsel.

We appreciate the opportunity to offer our views today on S 565, the "National Affordable Housing Act" particularly on those issues affecting homeownership affordability. This roundtable discussion is a unique opportunity to discuss at length the role of the mortgage insurance programs of the Federal Housing Administration (FHA) in assuring adequate access to mortgage credit, particularly for first time home buyers. The bill also includes proposals to assist potential borrowers to accumulate downpayments by providing access to Individual Retirement Accounts or 401(k) plans.

The Cranston-D'Amato bill represents a comprehensive reanalysis of the Federal housing delivery system. A number of themes emerge in the proposal--flexibility in the housing

*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of housing and other real estate finance. MBA's membership comprises mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios. Members of MBA include:

- Mortgage Banking Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Mortgage Insurance Companies
- Life Insurance Companies
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; telephone: (202) 861-6500.

delivery system, promoting affordability, particularly for first time home buyers and in high cost areas, and maximizing housing assistance by creating working partnerships among state, local and federal governmental entities as well as nonprofit and private housing developers. MBA's statement will analyze the proposals as well as address the issues posed as questions for the roundtable discussion.

SINGLE FAMILY HOMEOWNERSHIP AFFORDABILITY

The homeownership affordability provisions of S 565 would expand the utility of the FHA mortgage insurance program--particularly to first time homebuyers and homebuyers in high cost areas.

Reduce FHA Down Payments

Downpayments are probably the most significant impediment to homeownership. S 565 would lower downpayments to a flat 3 percent for first time homebuyers who complete prepurchase financial counseling. For all FHA loans, downpayments would be decreased somewhat to 3 percent of the first $50,000 (rather than the current law, which is $25,000) and 5 percent of the balance.

MBA strongly believes these modest changes will ease the accumulation of the necessary cash investment while, at the same time, not seriously affecting the borrower motivation to continue to make monthly payments. These changes recognize the fact that there are growing numbers of borrowers who may have the income necessary to meet their monthly obligations, but simply lack the cash reserves to make the necessary downpayment.

Removal of Limit on FHA Maximum Mortgage Amount.

MBA believes that the current FHA mortgage limits have restricted FHA from serving many homebuyers, particularly in high cost areas. We have prepared the following chart comparing average sales prices for existing housing with the FHA maximum mortgage limits. (The years chosen correspond with years that the FHA mortgage limits were raised.)

Year	Existing Housing Average Sales Price	FHA Mortgage Ceiling	FHA ceiling as precent of average sale price
1969	$21,800	$33,000	151%
1974	$32,000	$45,000	141%
1977	$42,900	$60,000	140%
1979	$55,100	$67,500 ($90,000 in high cost areas)	123%*
1988	$85,600 (1987 data)	67,500 ($101,250 in high cost areas)	79%*

*For areas above $67,500 and below the high cost area maximum, the limit would be approximately 95 percent.

As can be seen, contrary to allegations that FHA limits have been increased too often, FHA mortgage limits have dropped dramatically over the last twenty years. In 1969, the FHA mortgage ceiling was more than 50% higher than the average sales price. While the National Association of Realtors has only maintained this data since 1968, we believe that the same relationship existed throughout FHA's earlier years.

Congress has taken action to respond to a portion of this problem by raising the ceiling in high cost areas up to a maximum of $101,250. However, in high cost areas where the

median sales price far exceeds the $101,250 ceiling, like California, New England, New York and Washington, DC., that ceiling may only be 80 percent of the average sales price.

Under S 565, the current formula for determining FHA maximum mortgage amounts would be eliminated and replaced with another. The proposed amendment would establish FHA mortgage ceilings at 95 percent of the median sales price by either state or by multi-state metropolitan statistical area. However, the HUD Secretary could also designate substate areas for this treatment where it was determined to be necessary to "provide moderate- and middle-income persons with fair access to FHA insurance."

While MBA strongly endorses an adjustment to the FHA maximum mortgage amounts, this proposed formula presents several concerns. First, the bill possibly eliminates the floor of $67,500, which affects states with generally lower housing prices and will have to be closely studied. Second, although it allows higher limits in areas that are designated as high cost by the HUD Secretary, other than "fair access to FHA insurance," there are no standards for determining precisely which areas will be covered. The measure of housing affordability brought by access to FHA should not suffer potentially by being politicized. Because of this potential uncertainty, MBA supports the current formula of setting the FHA maximum mortgage amount at 95 percent of median sales price for the area, but with an amendment to eliminate the cap. This would allow FHA to serve borrowers equally in all markets.

Counseling.

FHA has consistently been a strong source of financing for first time home borrowers and marginal borrowers. In 1988, approximately 70 percent of FHA loans were made to first

time borrowers. While MBA strongly endorses reducing the downpayment requirement to a flat 3 percent for first time homebuyers, we do have some concerns about tying eligibility to a prepurchase counseling requirement. Program eligibility should not be denied to individuals who are able to meet all other eligibility requirements, but for whom prepurchase counseling is not freely available.

MBA does not question the validity or utility of prepurchase counseling. A 1976 report of the House Government Operations Committee concluded that, "Initial counseling for prospective purchasers can provide information about the rights, responsibilities, and costs of homeownership." ("Counseling Low-Income Homeowners", p.4, HRpt 94-1187). MBA has consistently supported both prepurchase and default counseling programs since their inception.

However, at present, most housing counseling services approved by HUD are aimed at delinquency counseling, rather than prepurchase counseling. Therefore, there presently may be an inadequate network of prepurchase counseling in some areas and in all likelihood no housing counseling at all in may other areas. HUD's standard for adequate coverage by housing counseling agencies would be "...one agency per rural county or per 10,000 properties in cities." as established under its Housing Information Advice and Assistance Program (HIAAP). Source: Housing Counseling/Housing Management Representatives Handbook 7610.4, March 1975, p.4.

As of August 1988, there were approximately 500 HUD-approved counseling agencies located in 43 states, plus Guam, Puerto Rico, and Washington, D.C. Many of these agencies were concentrated in urban areas, although some states, such as Oklahoma, had fairly extensive agency networks despite a generally rural character. However, other large states, for

example, Montana, had only one agency in the entire state. No agencies, whatsoever, were located in South Dakota, Maine, Vermont, New Hampshire, Hawaii, Idaho, and Wyoming.

The chief problems have arisen because neither prepurchase nor delinquency counseling programs have been sufficiently funded, and they, therefore, have had to rely on a network of private, primarily nonprofit agencies. These agencies, in turn, because they have had so little funding support from the Federal government, have been reluctant to devote their scarce resources to providing statistical information with regard to their success rates and programs. HUD's role has been confined to providing limited training, source guidebooks, and a program approval function.

In the past, Congress tied eligibility for mortgage insurance to a prepurchase counseling requirement under Sections 235 and 237, because these programs served high risk purchasers. HUD responded to this requirement by providing homeowner booklets. (HRpt No. 94-1187, p.12). While this was viewed by the House Committee on Government Operations as an insufficient response, in all practicality, HUD had little alternative because it was faced with a low funding level for counseling programs and insufficient numbers of approved counseling agencies to meet the legislative requirement for prepurchase counseling.

Although MBA recognizes the risk of reducing downpayment requirements and believes that appropriate prepurchase counseling and underwriting can reduce that risk, we also believe strongly that eligible families should not be denied access to the first-time homebuyer program due to the possible unavailability of counseling services.

Another factor to consider in requiring prepurchase counseling is timing. Counseling should be made available on a timely basis or a course certification should be good for an adequate time period after completion, so that potential borrowers will not run the risk of a purchase contract or financing commitment expiring before prepurchase counseling could be completed.

MBA suggests that thought be given to alternatives, such as stronger underwriting standards, which HUD could develop for such programs in order to minimize risk. We suggest further that the requirement could be an alternative, at the election of the borrower--that is, the borrower could undergo prepurchase counseling or be subject to stricter underwriting standards in order to be able to qualify for the lower downpayment program. Another alternative would be to waive the prepurchase counseling requirement if a program was unavailable in a geographic area or the counseling could not be completed in the time period necessary to process a loan (approximately 30 to 60 days.)

Adjustable Rate Mortgages--Expansion of Authority.

MBA strongly supports the provision in S 565 that would allow FHA to insure any type of adjustable rate mortgage (ARM) that "has achieved general acceptance in the private mortgage market," because this change will open the way for FHA to provide more flexible product lines that are more readily acceptable to borrowers and investors.

ARMs were developed in response to the affordability crunch created by rising interest rates in the early 1980s. While there were problems with early ARM instruments, the development of effective consumer protection measures has made these instruments reasonable alternatives for many borrowers. Because of limitations in the current FHA ARM

program (1 percent cap on annual adjustments), these loans are generally not priced favorably in the market, making them of little use to borrowers. Thus, borrowers lacking the additional downpayment or income required for conventional ARM mortgages are denied access to this instrument and the lower relative interest rates under this program.

With regard to the potential adverse impact of an increase of the annual cap to 2 percent, MBA agrees that 2 percent adjustments are not for every FHA borrower. As the servicers of the vast majority of FHA loans, mortgage bankers are all too familiar with the problems created by defaults and foreclosures for the borrowers, not to mention the financial expenses for the lender. Additional underwriting protection must be built into the loan origination process of these products (e.g. underwrite at the maximum second-year rate). In this way, eligible borrowers are protected against unnecessary risk and thousands of homebuyers who do not have the downpayment for a conventional loan are able to take advantage of this instrument.

While MBA believes that consumers should thoroughly understand the possibility for payment increases and thus should receive adequate disclosures, the bill provides for a different disclosure than is currently required for conventional ARMs. The Federal Reserve Board, the Federal Home Loan Bank Board, and the Office of the Comptroller have worked hard on this issue and have resolved differences and adopted a uniform ARM disclosure. MBA urges that FHA-ARMs be subject to identical disclosure requirements, because consistent disclosures will allow prospective borrowers to evaluate comparable mortgage products with ease, irrespective of the type of lender or whether the loan is conventional or government backed.

Downpayment Savings Plans.

On the tax side of the homeownership affordability quotient, the bill would allow first-time homebuyers to use funds in their individual retirement accounts or 401(k) plans as a downpayment. Section 565 permits individual retirement accounts and annuities (IRAs) and deferred cash arrangements (401(k)s) to be used as vehicles to save for a downpayment on a principal residence. In order to limit this use to those segments of the population who most likely need such assistance, the purchase price of the home is limited to 110 percent of the average area purchase price, and the prospective homeowner cannot have owned a home for at least the last three years.

In addition, there are limitations on the amount that can be provided to the plan participant, which can exceed $10,000 only in high cost areas (where the average area purchase price is higher than the average U.S. purchase price). Also, only contributions made to the plan more than one year before the arrangement is entered into are available in full. Only 33 percent of the contributions made within the immediately preceding 12 months can be used toward the housing downpayment. MBA believes this cap on recent contributions is unnecessarily restrictive. The tax law already limits the amounts that can be contributed to these plans.

Section 565 offers two alternatives for IRA and 401(k) amounts to be used for downpayments: the plan can take an ownership interest in the home in exchange for the amount provided to the plan participant, or the amounts can be treated as a loan. Under both arrangements, the "qualified home equity participation arrangement" and the "qualified home purchase loan," the amount has to be paid back to the retirement fund.

To qualify as an equity arrangement, the retirement fund's fee interest must be equal to the same percentage as the amount provided bears to the home's purchase price; furthermore, the amount must be repaid in full when the house is sold. The equity cannot be used as security for any other loan on the home. To qualify as a loan arrangement, the retirement fund must take a security interest in the home and repayment must begin at the start of year two and be completed over the next 15 years at a level amortization.

MBA is seriously concerned that, under both arrangements, the amount provided to the plan participant is not considered to be a tax-deferred distribution. MBA believes the amount should be treated as a distribution and included in taxable income at a future time, either when the house is sold or ratably over a period of years. This treatment would leave the downpayment equity free and clear. Under both arrangements proposed in Section 565, there really is no equity contribution (downpayment) to protect the security interest in the event of default, because in both instances the retirement plan must be repaid. In the event of a default, the retirement fund, not the lender or the mortgage insurer, would be repaid the equity contribution.

Under the equity arrangement, the homebuyer does not own 100 percent of the house. Presuming that the retirement fund amount represents the entire downpayment, the plan participant's ownership interest consists entirely of the mortgaged portion. For example, the fund provides for a $10,000 downpayment on a $50,000 house and takes a 20 percent ownership interest, leaving an 80 percent ownership interest for the plan participant. The lender would be making a no-downpayment loan to the borrower, because the lender's mortgage would be secured entirely by the 80 percent ownership interest that has no equity.

Under the loan arrangement, the retirement plan has a security interest equal to the amount of the downpayment. It is not clear whether the lender providing the mortgage has a first lien on the house. It is unlikely that a lender would take back a second lien on the property. In addition, MBA is concerned that beginning in year two, the borrower will be required to make two loan payments. When doing its underwriting, the lender will have to take this obligation into consideration and would effectively be qualifying the borrower for a 100 percent loan, which negates the purpose of the downpayment proposal under consideration.

MBA believes that this mechanism would be more acceptable to lenders if the borrower was not required to repay the amount to the retirement fund, especially if the amount represents the entire downpayment. Including the amount in taxable income at the time the house is sold would offer several benefits. The Federal government would get the revenue, and the taxpayer would have the cash to pay the tax bill. Otherwise, the amount could be included ratably in taxable income, after the borrower has been in the house for a specified period of time. If the borrower stayed in the house over a long period of time, the investment in the home would be the equivalent of saving for retirement. Neither giving the retirement plan an equity interest nor, alternatively, treating the retirement fund amount as a debt of the borrower puts the prospective homeowner in an advantageous position from the lender's viewpoint. Neither makes the plan participant a better credit risk.

S 565 would also extend the mortgage revenue bond and mortgage credit certificate programs through 1992--this longer term extension is helpful to prevent the constant threat of program shutdown present in one year extensions. MBA supports these important components of this proposal.

EXPANDING HOMEOWNERSHIP OPPORTUNITIES: THE ROLE OF FHA

As homeownership affordability becomes an increasing problem, Congress has been exploring alternatives to address this problem in order to increase the rate of homeownership in America. A major focal point for this discussion has been the recommendations of the National Housing Task Force that was commissioned by Senators Cranston and D'Amato, which have been incorporated in S 565. In the discussion of the specific topic issues for this roundtable, it is first appropriate to point out the role that FHA has played over its 50 year history. This brief review is necessary because the Mortgage Insurance Companies of America (MICA) continually makes the erroneous argument that FHA has drifted away from its fundamental mission. MBA believes that FHA's actions over the years are totally consistent with its tradition and have been essential to the ongoing operation of the housing finance system in many parts of the country.

Throughout its history, FHA has been able to serve more than 15 million homebuyers by blending its fundamental social purpose of expanding homeownership opportunities with prudent fiscal responsibility. This management philosophy has enabled FHA to assist many families who could not have purchased a home without FHA while, at the same time, has permitted the FHA Mutual Mortgage Insurance (MMI) Fund to accumulate over $3 billion in reserves. In this regard, it must be remembered that, at its foundation, FHA administers an insurance program. Like any successful insurance company, FHA must adhere to fundamental insurance principles that include the pooling of risks of possible loss across a large enough group of persons to minimize losses that inevitably will occur.

Within this basic framework, FHA insurance has allowed mortgagees to offer more liberal terms to low-, moderate-, and middle-income borrowers, expanding greatly the number of families who can afford to purchase their own homes. Amortization of loans over longer periods and lower cash investments are two examples of how FHA experience transformed mortgage lending practices in this country and offered homeownership opportunities to families who otherwise would be unable to purchase homes.

While MICA maintains that FHA should serve only low income families, it is clear that they are unconcerned with the ingredients that comprise FHA's formula for success. Because the FHA Section 203(b) is an insurance program that operates at no expense to the taxpayer, it is essential that FHA have a broad base of borrowers over which to spread its insurance risk. By its very nature, FHA insurance benefits some borrowers at the expense of others. In fact, through HUD's uniform premium structure, one group of borrowers actually pays the costs (subsidizes) the homeownership opportunities of high risk, marginal, and often lower income borrowers. For that reason, there are no references to the income of Section 203(b) borrowers throughout that section of the National Housing Act.

This is not to say that FHA should operate unbridled in the marketplace. FHA has always used reasonable mortgage limits to target its loans. In fact, contrary to the implications of FHA's opponents, FHA's mortgage limits are lower today than they were 20 years ago on a relative basis as compared to national existing housing average sales prices.

In the last several years, we have seen another example of the importance of FHA to the marketplace. FHA provides mortgage insurance in all market areas with the same underwriting criteria at the same cost. Private mortgage insurers have altered their client base

and their requirements over the years as they have experienced losses on new mortgage instruments, creative underwriting, or in response to downturns in regional economies.

In recent years in response to unprecedented losses, (see Moody's Investor Services' Annual Report for 1986 for documentation as to the severity of the problem), MIs have reevaluated their risk management operations, the principal result of which has been a considerable tightening of underwriting requirements. Some examples of changes include the following:

- Lower expense-to-income ratios especially for loans with 91 to 95 percent LTVs.
- Imposition of geographic limitations (i.e. no investor loans or tighter underwriting requirements in economically depressed areas).
- Mandatory borrower cash investment (i.e. gift letters only for downpayments above 5 percent).
- Cash on hand after closing to pay at least two months' mortgage payments.
- Minimum loan amounts of $30,000 or more.

One only has to talk with state housing finance agency officials to understand the impact of these changes and the retrenchment of the MI industry. In a survey of 10 state housing agencies, each agency has been compelled to rely heavily, if not entirely, on FHA in the last several years to meet the housing needs of lower income families. MIs have almost totally withdrawn from the state housing programs.

In addition to the almost universal concern expressed by state housing agencies, we have witnessed considerable tightening of MI guidelines in the economically distressed areas of Texas, Oklahoma, Colorado, Louisiana, and Alaska. MBA understands fully the reason for

this shift in management philosophy. However, if FHA had not been there to keep the housing industry viable in these states, homeownership opportunities would have been virtually nonexistent for average Americans lacking the downpayment and income necessary to meet extremely rigorous underwriting guidelines. Fortunately, FHA was there to meet its social responsibility, much as it has been many times throughout its history.

The commitment by FHA to meet a social responsibility has not occurred without a price. As we will discuss later, FHA has incurred a significant portion of their recent claim problems in the states from which the MIs have retreated for prudent business reasons. As a general comment, MICA wants to tamper with the delicate balance that exists between FHA's social purpose and actuarial soundness by placing arbitrary restrictions on FHA (e.g. income restrictions and lower mortgage limits). MBA believes that if these suggestions were adopted that they would harm the American homebuying public that relies on FHA insurance.

The following chart provides a comparison of borrowers served by FHA and the MIs in 1986.

	FHA	MI
Total # of Loans-1986	921,370	585,987
Loans within FHA mortgage limits	921,370	351,592
Borrowers below $40,000	534,400	179,500
Loans under $60,000	425,000	211,000

FHA served about three times the number of borrowers with incomes under $40,000 than did the MIs. FHA did twice as much business in loans under $60,000 as did MIs.

In 1986, the Congressional Research Service completed a study about proposed OMB changes to the FHA program that indicated borrowers with incomes over $40,000 are concentrated in areas where $40,000 is needed just to buy median priced housing. FHA borrower characteristic data for 1987 indicate that borrowers with incomes over $40,000 should not be considered wealthy.

- Six of every 10 FHA borrowers were first-time homebuyers. These borrowers do not have cash reserves that result from the appreciation generated from owning a home.

- In 60 percent of cases where the borrowers were a husband and wife, both worked.

In periods of higher interest rates (over 13 percent), a family with an income of $40,000 would have had trouble qualifying for a $70,000 mortgage.

Higher Income Borrowers Do Not Represent More Risk. Using a sample of claim data for 1982-1983, MICA has tried to make the point that borrowers with incomes over $40,000 making downpayments of less than 10 percent have a much higher claim rate than those loans made with downpayments of more than 10 percent. With this argument, MICA is trying to make the case that higher income borrowers making low downpayments are really a drain on the insurance fund. (It should be noted that the years chosen, 1982-1983, were years during which mortgage interest rates were at historically high levels and that defaults during those years were unprecedentedly high.) Default risk is related to a number of elements, including the amount of the downpayment, the creditworthiness of the borrower, the loan amount (to some degree), and geographic economic factors.

However, the following chart counters this assertion by showing that default risk has been generally higher for lower balance FHA loans than for higher balance FHA loans.

FHA Single Family Mortgages--Third Year Claim Rates, 1981-1986*

By Loan Amount and Fiscal Year of Endorsement

Loan Amount	FY'81	FY'82	FY'83	FY'84	FY'85	FY'86	FY'81-86
< $50K	8.2%	10.7%	5.4%	0.1%	9.0%	4.9%	7.3%
$50K-60K	6.0	9.0	4.5	7.5	8.0	4.1	6.8
$60K-70K	5.3	8.0	4.1	7.4	7.5	3.8	5.3
$70K-80K	**5.3	**6.3	3.1	6.1	7.3	3.7	4.7
>$80K	—	—	2.6	6.1	7.2	3.6	4.7
——	—	—	—	—	—	—	—
TOTAL	7.3	9.6	4.6	7.9	8.0	4.1	6.5

*Percent of loans which defaulted within three years

** Includes claims on loans over $80,000, because there were too few this year to justify a subgrouping.

Source: Department of Housing and Urban Development, compiled by MBA.

The chart above shows that FHA loan performance improves as the mortgage amount increases. However, as part of the social mission of FHA, lenders are compelled to make FHA loans without regard to loan amount. The 1987 housing act, P.L.100-242, prohibits FHA lenders from imposing any minimum loan balance. At least one mortgage insurance company declines to insure loans under $30,000 on the basis of loan amount alone.

This chart also shows gradual improvement in FHA loan performance. To date, 1986 rates, for example, are lower than all others over a comparable period of time. Because 1986 was also a year of record volume, these lower rates portend continued improvement in FHA's overall loan performance over the coming months.

A recent GAO study also concluded that there was "A concern that over the last two years (1) the maximum loan amount that the MMI Fund can insure on an individual mortgage (the loan ceiling), and (2) the average mortgage amount the MMI Fund insures have not kept pace with home price appreciation. This is important because MMI Fund trends indicated that higher dollar value loans, through more stringent loan-to-value requirements or other factors, may be less risky since they have lower claim rates. If lower risk borrowers can no longer obtain FHA insurance because their loans are above the loan ceiling, then FHA may increasingly find itself insuring more risky borrowers, for whom claim rates may be greater." U.S. General Accounting Office, Financial Management, Federal Housing Administration's Accounting Methods and Section 203(b) Program, p.11.

The amount of the downpayment is a key variable in the homeownership affordability equation. For many potential homebuyers, accumulating the downpayment plus closing costs is the major obstacle preventing them from stepping onto the first rung of the homeownership ladder. The FHA program, by allowing people to buy with less than a 10 percent downpayment, supports higher levels of homeownership and higher levels of housing market activity. Also, despite the fact that FHA accepts high loan-to-value ratio loans the FHA program remains actuarially sound.

FHA's Actuarial Soundness.

MICA has raised concerns about the status of the Mutual Mortgage Insurance Fund which includes FHA's Section 203(b) program. MBA is also concerned about the continued strength of that fund. For that reason, MBA has introduced a variety of actions to reduce FHA's risk exposure that have since been implemented by the Federal Housing Administration. For example, MBA recommended the termination of the Section 245(b) Graduated Payment Mortgage Program, which allowed negative amortization above the original value of the property and proposed reducing the maximum loan-to-value ratio to 75 percent on investor transactions. Both of these changes have subsequently been enacted by the Congress. Because MBA recognizes the importance of actuarial soundness to the success of FHA, we will continue to analyze the claim situation in an effort to make improvements to the fund's status.

In our current analysis of FHA's recent claim experience, location is directly related to default risk. In the last several years, we have watched the oil states go through tremendous economic distress. These economic problems have resulted in unprecedented claim problems for all segments of the lending community regardless of loan criteria (e.g.low loan-to-value ratios). A look at their impact on FHA originations in 1985 and 1986 will demonstrate this problem.

22-940 O - 90 - 5

1985 Originations

State	Claims*	Mortgages Insured	Percent Claims
Texas	3,923	41,197	9.5%
Oklahoma	1,190	7,795	15.3%
Louisiana	604	5,867	10.3%
Colorado	2,065	26,602	7.8%
Wyoming	116	1,467	7.9%
Alaska	765	2,500	30.6%
Total (Oil States)	**8,663**	**85,425**	**10.1%**
Remainder of Country	11,377	366,099	3.1%
U.S. Total	**20,040**	**451,524**	**4.4%**

*Through December 1987

Oil states comprised 19 percent of HUD's originations and 43 percent of HUD's claims in 1985.

1986 Originations

State	Claims*	Mortgages Insured	Percent Claims
Texas	2,264	81,320	2.8%
Oklahoma	466	18,627	2.5%
Louisiana	200	15,711	1.3%
Colorado	1,012	56,864	1.8%
Wyoming	77	3,972	1.9%
Alaska	312	4,850	6.4%
Total (Oil States)	**4,331**	**181,344**	**2.4%**
Remainder of Country	3,790	749,823	.5%
U.S. Total	**8,121**	**931,167**	**.9%**

* Through December 1987

While the oil states' share of HUD's originations stayed the same in 1986 (19 percent), their percentage of claims rose to 53 percent. As these data demonstrate, the problem is far more complicated than very high ratio loans and less stringent underwriting criteria as MICA contends. While the easy answer would be for FHA to stop making loans in areas in

economic distress, we believe the devastation to these areas would be exacerbated by such an action since FHA is the major, if not the only viable insurance source in these areas that have been the most hard-hit.

A look at recent FHA and MI new originations underscores this problem. FHA's market share has risen from 9 percent in 1984 to 29 percent in 1987 in six key states (Texas, Alaska, Colorado, Louisiana, Oklahoma and Florida). At the same time, MI market share in these states dropped from 43 percent to 9 percent over the same period. The following chart geographically demonstrates this change:

MARKET SHARE OF TOTAL ORIGINATIONS
(In Percent)

	FHA				MIs			
State	1984	1985	1986	1987	1984	1985	1986	1987
Alaska	10	27	38	43	80	39	24	12
Colorado	21	29	32	45	27	13	6	6
Florida	6	9	12	17	48	30	12	10
Louisiana	6	10	16	23	33	22	9	7
Oklahoma	10	15	22	32	40	23	8	6
Texas	7	14	18	35	44	24	11	10
Six State Total	9	15	19	29	43	24	11	9

Note: Based on new business per state in dollars divided by total originations per state in dollars.

Sources for table: MI production by MICA. FHA production as reported by HUD. Total originations as estimated by HUD.

Accordingly, as FHA fills market voids left by the MI retrenchment, increased risk becomes an inevitable result. Such risk associated with problem markets is emerging as a key determinant in future claim losses regardless of loan underwriting standards (e.g. downpayment and credit ratios).

Recent FHA Business Quality

Because of the tremendous volume in the last several years (over 40% of FHA's portfolio was originated in 1986 and 1987), FHA's actuarial managers are looking at the quality of these mortgages as an indication of FHA's future actuarial soundness. In this regard, FHA's 1986 book of business had the lowest first year claim rate of any year in the analyzed period (15 years) and as the data above indicates, it would have been even better without the economic problems in the Southwest. We believe there are two key reasons for this improvement.

1. Tighter underwriting and better quality control procedures. Much like the rest of the industry, FHA acted in the mid-1980s to address problems that necessitated changes in its program guidelines. They have implemented an early default tracking system to monitor lender performance. They have increased substantially the number of staff (from 10 to 35) who visit lenders and review loan quality and conformance with HUD guidelines. They have implemented a variety of underwriting changes which MBA supports (e.g. buydown restrictions, assumption processing, tighter underwriting criteria for shared equity loans and use of residual income only as a compensating factor). MBA believes that these changes have all contributed to this improved claim performance.

2. Better Loan Quality. Because of the unprecedented drop in interest rates in 1986, many homeowners took that opportunity to refinance their existing FHA mortgages with new mortgages at lower interest rates. While this is probably only a one-time phenomenon, its net result is to greatly improve the quality of FHA's portfolio. These mortgagors who paid the same premium as high risk, low income borrowers buying their first home will,

consistent with FHA's history, pay the program costs to enable FHA to carry out its social responsibility. MICA's response to this occurrence is to recommend the exclusion of refinances from FHA's program.

Recently, there has been a great deal of publicity with regard to the claim that FHA has added to the deficit. This is a bookkeeping matter, rather than a marked change in the status of the FHA MMI Fund. Simply put, the amount of loans written in 1988 fell off dramatically due to lack of consumer demand--therefore, revenues from the upfront mortgage insurance premium were insufficient in 1988 to cover default losses on all loans prior to that year. When this occurs, less funds are available from the MMI Fund to be invested as required by law in Treasury securities--and this technically results in an increase in the U.S. deficit. This occurrence does not imply, however, that the risk balance associated with the FHA has changed dramatically, as evidenced by the favorable recent audit analysis and report issued on FHA by the GAO. (GAO/AFMD-89-26BR) And as that audit analysis concluded, the FHA MMI Fund still maintains significant reserves of over $3 billion.

CONCLUSION

The success of the Federal Housing Administration has surely exceeded the expectations of its founders. MBA supports the initiatives in S 565 that will make certain that FHA remains current with the needs of the American homebuyer. These enhancements to FHA can be the cornerstone of the Federal Government's effort to expand homeownership opportunities. With the changes recommended in S 565, MBA believes that FHA can continue to flourish and assure that the dream of homeownership remains available for low, moderate, and middle income families at no cost to the American taxpayer.

MBA sincerely appreciates your willingness to both listen to our concerns and solicit our opinions. While we indeed recognize the budget constraints this Nation faces, there are social needs that must be addressed; efficient and responsible mechanisms must be made available in order to face and meet those social responsibilities. We sincerely appreciate your interest in hearing MBA's views on this important legislation.

STATEMENT OF WILLIAM H. LACY, PRESIDENT OF
THE MORTGAGE INSURANCE COMPANIES OF AMERICA BEFORE THE
HOUSING SUBCOMMITTEE OF THE SENATE BANKING, HOUSING
AND URBAN AFFAIRS COMMITTEE

June 9, 1989

Mr. Chairman and Members of this Subcommittee:

The Mortgage Insurance Companies of America (MICA)* appreciates this opportunity to offer its views on the National Affordable Housing Act. MICA commends Senators Cranston and D'Amato and both the majority and minority staffs of the Housing subcommittee for their work to focus the Congress and the nation on housing as a national issue. This legislation is a recognition of the urgent need to help house Americans, and we support your efforts to address these problems. But as our comments here will show, there is an aspect of this bill that runs counter to this goal. Expanding the Federal Housing Administration (FHA) as proposed in this bill is socially unacceptable and fiscally irresponsible. It will hurt, not help, the nation's homebuyers and taxpayers. We are rapidly becoming a nation of housing haves and have nots, and the fundamental injustice of these proposals to expand FHA only will exacerbate this growing disparity.

MICA believes people at the margin of homeownership should be the focus of the nation's housing policy. Unfortunately, the government's primary program to increase homeownership -- the FHA -- is being pulled away from this segment of the population. All too often, government programs tend to develop their own constituencies over time, and in the case of the FHA, that constituency is the housing industry. The housing industry depends on FHA financing to help sell homes. But selling homes is not the purpose of housing policy, helping put people into homes and keep them there is. MICA believes that as Congress formulates a new national housing policy, it has the opportunity -- and the need -- to reexamine FHA's mission and refocus this vital government program to ensure that the proper goal is being met.

MICA also believes that any actions to expand FHA must be made with full knowledge of its growing financial problems. Given the nation's limited public resources and growing Federal deficit, Congress must scrutinize the financial instability of the FHA insurance program. Many well-intended government programs have eventually incurred financial trouble -- student loans, farm credit and the Federal savings deposit insurance system. The FHA is a vital component of the nation's housing system, and we must ensure its continued viability.

The task before this committee and this Congress is to maximize utilization of the nation's resources -- both public and private -- to provide the greatest possible benefit to those most in need. To that end, MICA's testimony will examine the following points:

*Mortgage insurance enables lenders to grant high loan-to-value ratio home loans which would otherwise be considered too risky. It makes more households with lower incomes and fewer assets eligible for homeownership. Since the industry was founded in the late 1950s, it has put 8.5 million people, primarily first-time homebuyers, into homes and has paid over $5 billion in claims to lenders and investors ($2.5 billion of which went to FSLIC insured institutions and over $600 million to FNMA and FHLMC) on behalf of homebuyers who lost their homes.

- Expanding homeownership requires expanding the base of people who can become homeowners. Limited Federal resources must be targeted to those on the margin of homeownership -- people who might not become homeowners without government assistance. The bill ignores the low- and moderate-income people who need help, and instead provides government assistance to people in the top 20 percent income bracket.

- To reach those most in need, FHA should be targeted by income, not home price. FHA should help people who were having trouble becoming homeowners. Targeting FHA by home sales price does not help young, first-time homebuyers, it only sells homes to higher-income households.

- Expanding FHA by home price rather than income is inflationary. FHA's liberal terms will allow higher-income buyers to leverage their debt, encouraging speculation and leading to inflated house prices.

- This is the wrong time to expand FHA. Congress needs to ensure that FHA is available to serve people who need the program far into the future. FHA is losing money, to the tune of $368 million last year, and potentially $1 billion by 1990. The National Affordable Housing Act will exacerbate FHA's growing financial troubles.

- FHA is using today's premiums to pay for yesterday's losses, retaining little for tomorrow's losses. Some proponents of proposals to raise FHA loan limits claim the measure is needed to allow FHA to "grow out" of its problems by insuring higher-balanced loans and collecting more premium income. FHA cannot grow out of its losses.

- High-income borrowers will add more, not less, risk to the FHA program. It is clearly downpayment, not loan size or borrower income, that drives default. Private data consistently shows higher default rates as loan balances increase. FHA's risk will be increased as high-income borrowers looking for maximum leverage on their assets take advantage of the program.

- Raising FHA's loans limits deal with the symptoms of the housing affordability problem, not with the causes. The housing affordability problem cannot be solved by liberalizing financing, but can be addressed by doing more to help borrowers accumulate a downpayment, giving builders incentives to construct less expensive homes and addressing other issues associated with high housing costs.

- Submedian does not imply substandard. Many homes below the median price are both affordable and adequate for the first-time homebuyers traditionally served by FHA.

- Expanding FHA's ARM program would result in more families losing their homes. It would not expand homeownership opportunities for low- and moderate-income families who

need the stability of fixed payments. The government should not expose families to payment shock and increased default rates.

Defining Housing Affordability

MICA believes the way to increase homeownership is to broaden the base of people who can become homeowners. The FHA provisions of the National Affordable Housing Act do not expand this base, but instead enable people who can already afford to buy a home purchase one more easily with government help.

Today, in some parts of the country, high interest rates and high home prices make homeownership expensive. There are communities with "no growth" and restrictive zoning policies that inflate home prices and push homeownership out of many people's reach. Blue- and white-collar workers who cannot afford homes are people who are vital to our communities -- they are teachers, firefighters and truck drivers. They have good jobs with steady incomes but they have difficulty making the leap to homeownership. To expand homeownership, we must target limited Federal resources to these people at the margin of homeownership.

Raising FHA's Mortgage Limits

One element of the National Affordable Housing Act proposes to expand homeownership by allowing FHA to insure mortgage loans up to 95 percent of area median sales price. This proposal does nothing

to expand the number of people who can become homeowners. Proponents of this proposal claim it is needed to provide equal access to FHA by homebuyers in high-cost areas of the nation. However, allowing FHA to insure expensive homes will not help borrowers at the margin of homeownership in high-cost areas because they do not have the income necessary to make the monthly mortgage payment on the median-priced home. People are not excluded from homeownership because FHA ceilings are too low. They are excluded because home prices are too high. Appendix I illustrates that an affordable home for a teacher or police officer is far below the proposed FHA limits.

In fact, only a few homebuyers earning $50- to $100-thousand a year in high-cost metropolitan areas will be able to buy larger homes more quickly as a result of increasing FHA's limits. These more affluent families' housing needs already are being met by the private sector, and this segment of risk is borne by private capital. The priority for government assistance should be low- and moderate-income families where the real need lies.

Helping high-income borrowers in high-cost cities does not help address the housing affordability problem. A recent study by Congressional Research Service (CRS)* confirmed this fact. It concluded that "changing the FHA mortgage limits does not address the [housing] affordability issue. If a family does not have the income to purchase the median-priced home, it does not matter

*Foote, Ellington B., "Federal Housing Administration Raising the Mortgage Limits," CRS Report for Congress (April 19, 1989).

whether that median is above or below the FHA mortgage limit." The study states, "It is misleading to use the median sales price as a measure of housing affordability."

The study notes that upper-income people on the East and West Coasts will be the sole beneficiaries of the increased limits. The bulk of the nation will not find it easier to purchase a home as a result of this bill. The CRS report contains an "FHA Affordability Index" that measures the degree to which homebuyers in given communities may be able to purchase the median-priced home using FHA-insured financing. In all but 12 of the 62 metropolitan statistical areas studied, the current FHA limit is more than enough to purchase the median-priced home.

Raising the loan limits, therefore, will only benefit someone earning $110,000 a year in San Francisco, $80,000 in Los Angeles and $85,000 in New York. People earning these salaries are in the top 20 percent of the nation's income level, and in some markets, the top five percent. (See Appendix II). On the other hand, the typical first-time homebuyer, has a median income of $35,700 and paid $84,100 for a house, according to a study by the National Association of Realtors. To expand homeownership, FHA must serve this market. The CRS study appropriately asks, "In an era when most entitlement programs are being targeted to those most in need, should the FHA insurance program be expanded to accommodate higher-income families buying higher-priced homes?" The resounding answer is "NO."

More importantly, raising the loan limits actually will hurt low- and moderate-income homebuyers because it will cause the prices of homes to rise. Builders currently are building more luxurious homes because there is a large market for them. This trend will continue if there is a readily available source of inexpensive financing.

In an article in the May 5, 1989, issue of Real Estate Finance Today (see Appendix III), Richard Peach, Deputy Chief Economist for the Mortgage Bankers Association of America, states that "during the late 1970's home builders were, to a large extent, producing entry level homes to satisfy the demands of the large number of baby boomers who wanted to purchase their first home. Today, however, many of those same baby boomers have larger families, accumulated equity and higher incomes, and so can afford to move up to more spacious homes with more amenities. In reaction, home builders have made a significant change in their product. The new homes built in the late 1980s are considerably larger, and considerably more costly, than just a few years ago."

The propensity of builders to build to the upscale market and to the availability of inexpensive financing also points how fruitless it is to index the FHA loan limits to median house price. As builders use the FHA limits as their base price for new construction, more homes near the median price, rather than below it, will be built. This will drive up the median, with the FHA loan limit increasing right along.

The availability of FHA financing to high-income borrowers will also be inflationary. High-income buyers will use FHA financing to leverage their debt, creating speculation and leading to inflated home prices.

If FHA is targeted by home price, the basic principles under which it operates will act to push FHA away from lower-balanced loans. Congress acknowledged this problem a year and a half ago when it passed a housing law containing a provision to prohibit lenders from setting minimums on FHA loans. FHA loans are primarily originated by lenders who make their profits through origination and servicing fees that are based on a percentage of the loan amount. Thus, lenders are encouraged to seek larger, more profitable loans.

Other members of the real estate industry also benefit from higher FHA limits, primarily because financial incentives in the real estate market are based on home price. Raising the loan limits, therefore, will clearly increase the sales volume of larger homes -- to the benefit of several industry groups -- but it will do nothing to increase the number of people who can buy homes.

FHA's Growing Financial Problems

There is an increasing amount of evidence of FHA's financial problems, which calls into question its ability to serve families at the margin of homeownership into the future. The National Affordable Housing Act ignores FHA's difficulties and instead would allow higher-income people, who would use the program to increase the leverage of their mortgage debt and speculate on house prices,

to add more risk to the program. Rather than simply expanding it, Congress should take a closer look at FHA's financial status and strike a better balance between proper social policy and fiscal responsibility.

The myth that FHA does not cost anything is not true. A General Accounting Office (GAO) study of FHA's financial problems concluded that FHA added $643 million to the Federal deficit through August 1988. To help meet its fiscal year 1988 cash needs, FHA withdrew money from the U.S. Treasury by cashing in government securities before they matured. GAO conducted an audit of FHA for fiscal year 1987,* the first audit of FHA ever performed. The audit found that, using generally accepted accounting principles, FHA's reserves are $1.9 billion less than what FHA had reported. GAO adjusted FHA's equity down from $3.1 billion to $1.2 billion. The reserves of the Mutual Mortgage Insurance Fund (MMIF), which covers FHA's single-family lending program, were lowered by $600 million.

The MMIF will deplete its reserves by the early 1990s. GAO is expected to release its audit of FHA for fiscal year 1988 shortly. FHA reported losses of $368 million in fiscal year 1988 -- its first loss ever. The 1988 losses will likely double to $700 million or more in fiscal year 1989. MICA's projections indicate losses in 1990 could triple those of 1988 -- reaching nearly $1 billion.

If FHA were a private insurer, it already would have been shut down by state insurance authorities. The MMIF began fiscal year

*United States General Accounting Office, Report to Congress "Financial Audit Federal Housing Administration 1987 Statement of Financial Position." (May 1989 - GAO/AFMD -89-3).

1988 with $3.4 billion in reserves and $205 billion of insurance in force, giving it a 60 to one risk to reserve ratio. Private insurers under state law must maintain a minimum 25 to one risk to reserve ratio, but the prudent operating standard is 20 to one. FHA's present ratio, therefore, is three times the prudent private insurer's standard. Further expansion of FHA will distort this risk-to-capital ratio even more and will impact the Federal deficit.

FHA's problems are compounded by its inadequate pricing of the risk it insures. FHA's one premium rate for all loans, regardless of loan-to-value ratio, does not take into account the mortgage insurance principle that risk increases as downpayment decreases. According to a recent study by the National Association of Realtors, the average FHA loan-to-value ratio has been increasing, rising from 85.4 in 1984 to 94.7 in 1988. Most importantly, its break-even point allows for defaults of only eight percent on all loans originated in any one year. The last endorsement year to perform at or below this break-even benchmark claim rate was 1978. Loans insured by FHA over the last 10 years have, or will ultimately have, a claim rate of 13 to 26 percent. This claim rate is three to four times greater than that of the private sector.

The National Affordable Housing Act will contribute to FHA's growing financial problems by lowering the downpayment requirements on loans to high-income people. The FHA would require only a three percent downpayment for all first-time homebuyers, regardless of income or loan size. It also lowers the downpayment to three percent on the first $50,000 and five percent on the remaining loan

balance for all other FHA borrowers and once again does not take borrower income or loan amount into consideration.

It is a fundamental principle of lending that downpayment drives default. This principle has been proven by numerous empirical studies, including a 1969 study by George M. von Furstenberg published in The Journal of Finance (See Appendix IV). It is proven daily in the mortgage lending business. This principle was affirmed most recently in a GAO study* on FHA's financial management. GAO found that claim rates are as much as three to four times greater for loans with a three percent downpayment compared with those made with a 10 percent downpayment. The GAO data shows that more than one in every four loans with less than a five percent downpayment in the 1981 and 1982 policy years defaulted. This type of foreclosure rate is a financial disaster for FHA. If expanding the availability of these very low-downpayment loans is coupled with very high loan amounts, FHA's losses will continue to grow beyond a level of tolerance.

Mortgage insurance industry data confirms the correlation between low downpayments and high default rates. Appendix V provides the default rates for all loans insured by the mortgage insurance industry for a ten year period, by loan-to-value ratio. The table shows that the default rate for 95 percent loan-to-value

*United States General Accounting Office, Briefing Report to the Chairman, Committee on Banking, Housing and Urban Affairs United States Senate "Financial Management Federal Housing Administration's Accounting Methods and Section 203(b) Program" (May 1989-GAO/AFMD 89-26BR).

ratio loans is almost double the default rate of 90 percent loan-to-value ratio loans.

Raising FHA's loan limits just to collect more premium income each year, as some proponents advocate, will not solve FHA's severe financial problems. Since FHA collects its entire premium up front, the plan will mask FHA's difficulties only temporarily by putting it in an initial better cash position. As the claims from those loans start to come in, FHA will suffer losses unless it continues to generate enough new premiums to cover the claims payments. It must keep generating more business up front to pay for its claims. Eventually, however, the claims come in faster than the premiums as we saw in 1988 and will continue to see for the foreseeable future. (For a further discussion of this point see an article from Barron's in Appendix VI).

This argument is reminiscent of similar approaches used by some financial institutions in the early 1980s when they sought the authority to grow out of their problems. FHA cannot out run its losses. As discussed earlier, its claims incidence have reached disastrous proportions and taking in more premium income initially will not be enough to compensate for the losses. FHA is experiencing high incidence of claims from three to seven years after loans are originated. We have only begun to see heavy defaults on the large volume of FHA loans insured in 1986 and 1987.

Target FHA By Income

FHA should be targeted by income. This is the only way to ensure that FHA helps low- to moderate-income families acquire their

own home. Its goal should be to help low- and moderate-income people buy and keep homes, rather than introduce more favorable financing terms to sell more high-cost houses.

Other homeownership programs, such as the mortgage revenue bond program and the programs of many state housing finance agencies, are targeted by income. FHA should follow suit -- it should be available to families earning a certain percent of area median income. Anyone earning less than the designated percent of median would have full access to FHA with all its subsidy features. These subsidy features include the ability to make a less than five percent downpayment, to finance closing costs, to pay a below market rate insurance premium, and to purchase a home with an assumable loan. In addition, the 100 percent guarantee, the direct endorsement underwriting and the GNMA security (through which most FHA loans are financed) give the FHA loan an interest rate advantage in the market.

FHA can be targeted by income without putting greater risk on its dwindling reserves. In fact, lower-income families pay their mortgages as well as, and in some instances better than, higher-income people. Our industry has found that many higher-income people default when real estate values decline, even though they have the capacity to repay the debt. Higher-income people generally are more mobile and can leave a depressed area, creating a new phenomenon of defaults because of lack of willingness, rather than lack of ability, to repay mortgage debt.

In fact, the mortgage insurance industry believes in the ability and willingness of lower-income borrowers to pay their debts. Some of our larger companies have developed demonstration programs with the assistance of community groups to help lower-income families in several metropolitan areas around the country. The programs are designed to make more mortgage credit available to lower-income people and are targeted by income. They have more flexible debt-to-income qualifications and require less cash reserves. These companies fully expect to make a profit from this business.

Borrower income has little to do with default. As discussed in the previous section, the key determinant of default risk is downpayment. The $5 billion in claims paid over the last five years by private mortgage insurers prove that downpayment is the element that drives default. In the private sector, there is no evidence that higher-balance loans are less likely to default. In fact, the opposite is true: higher-balance loans are likely to default more often.

Appendix VII shows the claim rates on all privately-insured loans originated in 1982 and 1983 by loan amount. Loans over $80,000 had a higher probability of going to claim than smaller loans. Appendix VIII breaks out the loan amount categories by loan-to-value ratio and provides the claim rates. Once again, income was not a significant factor. In fact, loans over $80,000 with 90 and 95 percent loan-to-value ratios had a higher probability of going to claim than smaller loans with the same loan-to-value ratios. Loans with a 95 percent loan-to-value ratio had a much higher incidence of claims than loans with a 90 percent loan-to-value ratio in all loan amount categories.

As a result, if FHA is expanded as proposed in the National Affordable Housing Act, rather than targeted by income, a Federal program then will exist in which the poor subsidize the rich. Low-income homebuyers who save for a five to ten percent downpayment will end up cross-subsidizing high-income people who capitalize on the tax advantages of very high-ratio mortgage financing. Recent evidence from the Mortgage Information Corporation of America (no relation to MICA), which gathers mortgage information from local registrars of deeds, indicated that lower-income FHA borrowers subsidize the rich. Data for February of this year shows that in a small sample of cities, 9.5 percent of $30,000 FHA-insured loans had 95 percent or greater loan-to-value ratio. In contrast, 85 percent of $100,000 FHA-insured loans had 95 percent or greater loan-to-value ratios, indicating that more higher-balance loans have higher loan-to-value ratios.

Other Solutions to the Housing Affordability Problem

Rather than enabling borrowers to leverage their assets more highly, more ways should be developed to help them acquire equity in their home. MICA fully supports proposals in the National Affordable Housing Act and other bills which enable borrowers to use IRA money for a downpayment or to save for a downpayment in a tax free account.

MICA and National People's Action have developed a way to help low- and moderate-income homebuyers accumulate a downpayment which we believe is superior to many other programs. It would combine

both Federal and private resources to put people into homes. Equally important, it would require potential homeowners to work toward and save for their homes. It is structured so the homebuyer would have equity in the property and achieve the dream of homeownership in a shorter, more realistic period of time than is currently possible. Finally, it is targeted by income.

It is titled the Home Ownership Made Easier Program, or HOME Program. Under the HOME Program, eligible first-time homebuyers would be able to deposit funds in special savings certificates. These personal funds would be matched by the Federal government based on the homebuyer's income. The participants would be able to use these funds for expenses associated with a mortgage loan, including downpayment, closing costs or to buy down the interest rate. The homeowner would repay to the Federal government the funds it contributed to the certificate. A complete description of the program is found in Appendix IX.

Providing more financing techniques alone will not solve the housing affordability problem. Congress and the housing industry must examine alternatives that get to the root of the problem. First of all, builders need to start building less expensive houses that are within the price range of first-time homebuyers. Recent data from the Census Bureau shows that the quality of homes being built has significantly increased, greatly adding to their price. The size of and the amenities in a home have grown over time, which places the home out of the reach of most first-time homebuyers. Yet, as the CRS study states, "The FHA loan limit may be less than

the median sales price in a community, but many homes in the lower half of the price range may be both affordable and adequate for the homebuyers traditionally served by FHA....Submedian does not imply substandard."

Congress must insist that HUD and FHA study ways to build better starter homes and provide better financial incentives to encourage more affordable housing. For example, if homes are being built in areas where land prices are high, then more smaller units should be built on the land rather than a few expensive homes. If local zoning laws prohibit multifamily units, then homes should be built which would be considered less luxurious or even "unfinished," so that they are within the price range of first-time homebuyers. In addition, tax incentives could be given to developers to build smaller, less expensive homes. Federal money to local communities also could be conditioned on the local government providing incentives to developers to build more starter homes.

Expanding FHA's ARM Program

Any recommendation to resolve the housing affordability problem should never result in increased foreclosures, empty homes and displaced families. Proposals in the National Affordable Housing Act to expand FHA's adjustable rate mortgage (ARM) program will have the opposite outcome, resulting in more defaults. ARMs are designed for families who have sufficient income and financial assets to absorb higher housing payments. Families who cannot afford the payments on a fixed-rate mortgage today hardly can be expected to

afford tomorrow's growing payments on ARMs. Many ARMs today are being offered at initial teaser rates of three percent below the fully-indexed rate. In just 25 months after closing, the ARM rate could increase to at least 10 percent. On a $60,000 initial mortgage amount, the first ARM payment would be $400 per month; 25 months later the ARM payment at a rate of 10 percent would be $533, a 33 percent jump in the mortgage payment. Do we really expect people to be capable of making a 33 percent higher mortgage payment in two years if they cannot qualify now for a fixed-rate loan?

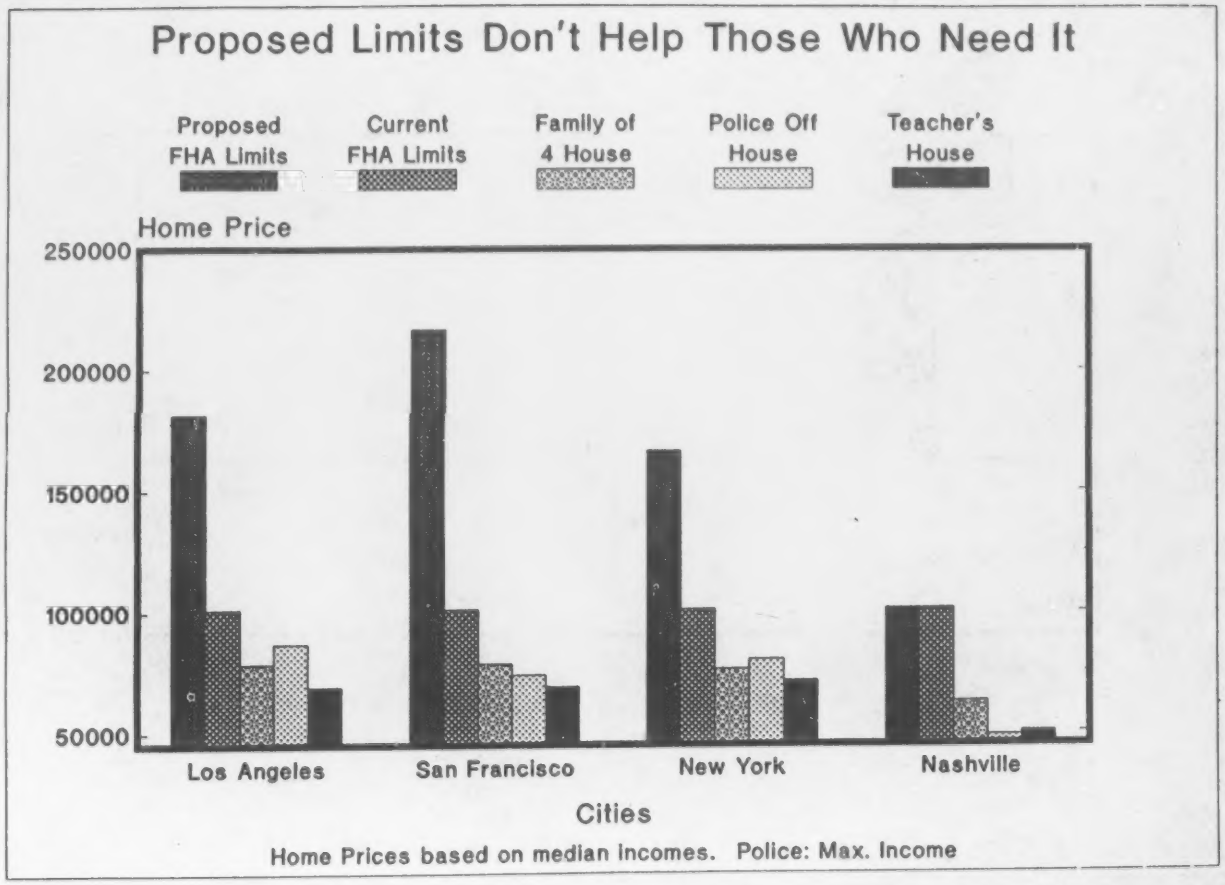
The bill would change the present FHA ARM program to enable the Secretary of the Department of Housing and Urban Development (HUD) to permit FHA to insure ARMs that are widely accepted in the market. This proposal is made in the name of parity between FHA and the conventional market. The conventional mortgage market, however, is driven by forces that have nothing to do with FHA's housing policy objectives. FHA is supposed to assist low- and moderate-income people achieve the dream of homeownership, not compete with private business. The private market created ARMs and continues to refine the instrument in an effort to help lenders and investors hedge against interest rate increases. ARM loans also help upwardly mobile borrowers receive lower initial mortgage rates. These two goals of the conventional market are not the same as FHA's. FHA's ARM program should not change.

Conclusion

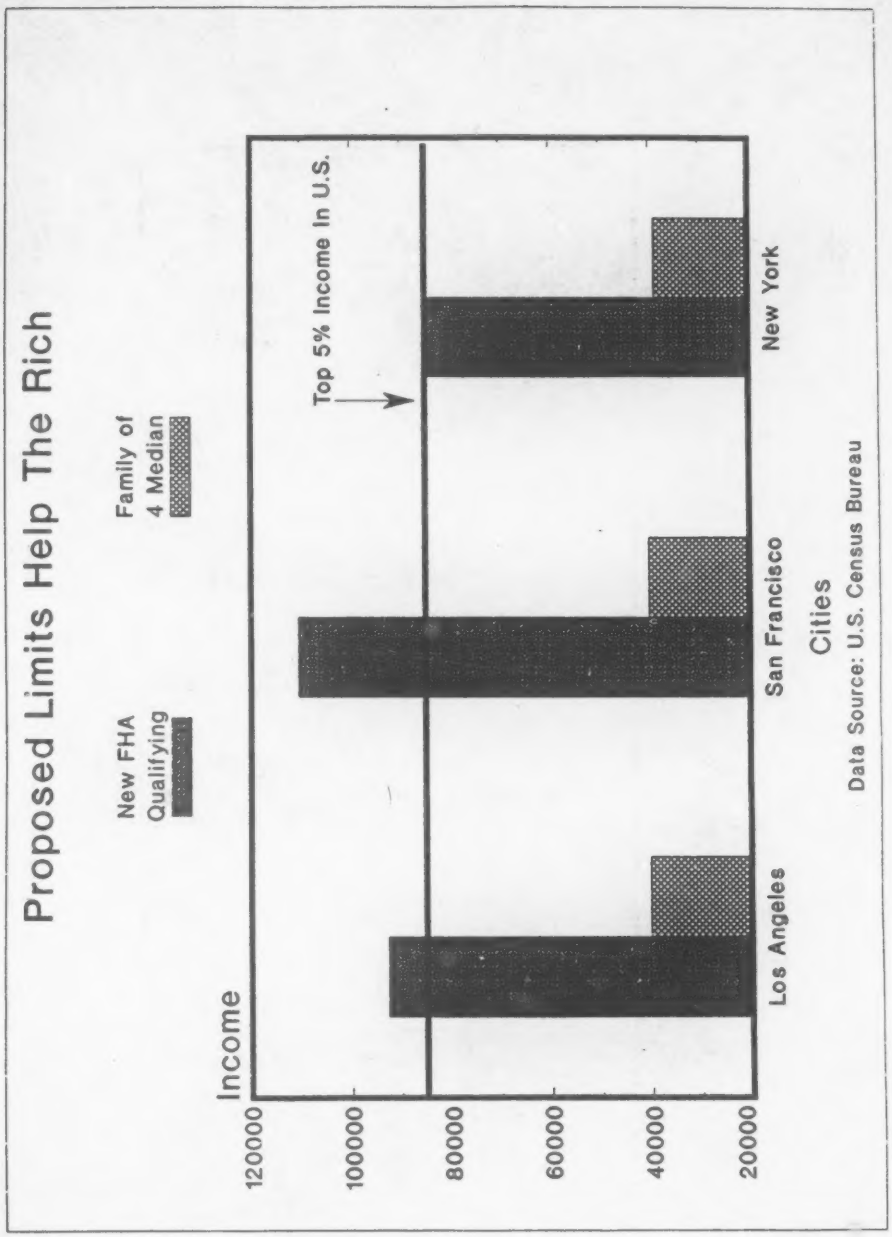
The proper role of government is to provide solutions to problems that private enterprise and initiatives cannot solve. It

should protect the overall welfare of its citizens, and its first priority should be taking care of those most in need -- those missed by the mainstream of private business. This was the original mission of FHA, and it is the direction to which FHA must return. The proposals to expand FHA presented in this bill serve only to further remove the FHA program from its real constituency -- the hard-working American families who deserve a decent home. Further, this bill would endanger FHA's future ability to serve the nation's homebuyers. FHA's financial problems demand attention now, before they catch us by surprise.

For almost five decades, FHA was a successful housing program that did not impact the Federal deficit. But the realities of home mortgage finance credit default risk have changed dramatically in the last decade, as evidenced by FHA's first-ever loss in 1988 and its expected continuing losses. This is not the time for Congress to expand FHA as proposed in this bill. Instead, Congress needs to take the time to revisit FHA's mission and examine its financial soundness. We must ensure FHA's continued viability for future American families who will need government assistance to achieve homeownership.


Proposed Limits Don't Help Those Who Need It
Proposed FHA Limits
Current FHA Limits
Family of 4 House
Police Off House
Teacher's House
Home Price
250000
200000
150000
100000
50000
Los Angeles
San Francisco
New York
Nashville
Cities
Home Prices based on median incomes. Police: Max. Income

Appendix II


Proposed Limits Help The Rich
New FHA Qualifying
Family of 4 Median
Top 5% Income In U.S.
Income
120000
100000
80000
60000
40000
20000
Los Angeles
San Francisco
New York
Cities
Data Source: U.S. Census Bureau

Trend Toward Larger New Homes Continued in 1988

Over periods of time as long as a decade, demographic factors exert a very strong influence on housing markets. The quantity, characteristics and location of the new housing units that are added to the stock of housing each year are largely determined by the quantity, characteristics and location of the increase in households.

For example, during the second half of the 1970s, when the number of households in the U.S. increased by about 1.94 million per year, housing starts reached peak levels of about 2 million units per year. By the second half of the 1980s, however, annual growth of the number of households had declined to about 1.5 million.

Despite a protracted economic recovery, high levels of employment and relatively favorable financial conditions, housing starts have also declined to an average annual level of about 1.55 million units. This trend is expected to continue over the remainder of this century, as the annual increase in the number of households declines to about 1.1 million.

Even more interesting than the demographic influence on the number of new housing units constructed each year is the influence on the characteristics of those new units. In the late 1970s, 44 percent of the annual increase in households consisted of households headed by individuals 34 years of age or younger, while just 20 percent were headed by individuals 35 to 54 years of age. By the late 1980s, just 5 percent of the annual increase in households was headed by individuals 34 years of age or younger, while the proportion headed by individuals 35 to 54 years of age increased to 75 percent. This dramatic change in the characteristics of the growth of households is due to the aging of the baby boomers, a large cohort of individuals born between 1945 and 1964 that has moved like a large bubble through the age structure.

The baby boomers have been the primary force on the demand side of housing markets for nearly two decades and will continue to be for decades to come. And as their housing needs and wants have changed, those businesses on the supply side of housing markets have responded accordingly. Thus, during the late 1970s home builders were, to a large extent, producing entry-level homes to satisfy the demands of the large number of baby boomers who wanted to purchase their first home.

The baby boomers have been the primary force on the demand side of housing markets for nearly two decades and will continue to be for decades to come.

Today, however, many of those same baby boomers have larger families, accumulated equity and higher incomes, and so can afford to move up to more spacious homes with more amenities. In reaction, homebuilders have made a significant change in their product. The new homes built in the late 1980s are considerably larger, and considerably more costly, than just a few years ago. As shown in Table 1, the median new single-family home completed in 1988

New Homes

Continued from page 3

had 1,815 square feet of floor area, up 3.4 percent over the 1987 median and nearly 20 percent above the 1982 figure. About four of every 10 new homes completed in 1988 had 2,000 or more square feet of floor area. In addition to more square feet, there is a clear trend toward more bedrooms, bathrooms, two-car garages, fireplaces and numerous other amenities.

This trend toward larger new homes clearly cannot continue indefinitely, but is likely to persist well into the next decade. During the 1990s, the baby boomers will be entering the 45- to 54-year age group, which, for many, will be the peak earning years of their career.

—Richard W. Peach is an MBA Deputy Chief Economist.

Table 1

SELECTED CHARACTERISTICS OF NEW SINGLE-FAMILY HOMES

	1982	1987	1988
Median Square Feet of Floor Area	1,520	1,755	1,815
2,000 or More Square Feet of Floor Area	25%	37%	41%
Four or More Bedrooms	18%	23%	26%
2-1/2 Bathrooms or More	22%	38%	42%
Central Air-Conditioning	66%	71%	75%
One Fireplace or More	54%	62%	65%
Garage: Two Cars or More	50%	65%	66%

SOURCES: U.S. DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, AND HUD, "CHARACTERISTICS OF HOUSING COMPLETED IN 1988," C25/89-34.

Appendix IV

BIBLIOGRAPHY OF LOAN-TO-VALUE STUDIES AND REPORTS

George M. von Furstenberg, 1970, "Technical Studies of Mortgage Default Risk;" An analysis of the experience with FHA and VA home loans during the decade 1957-66.

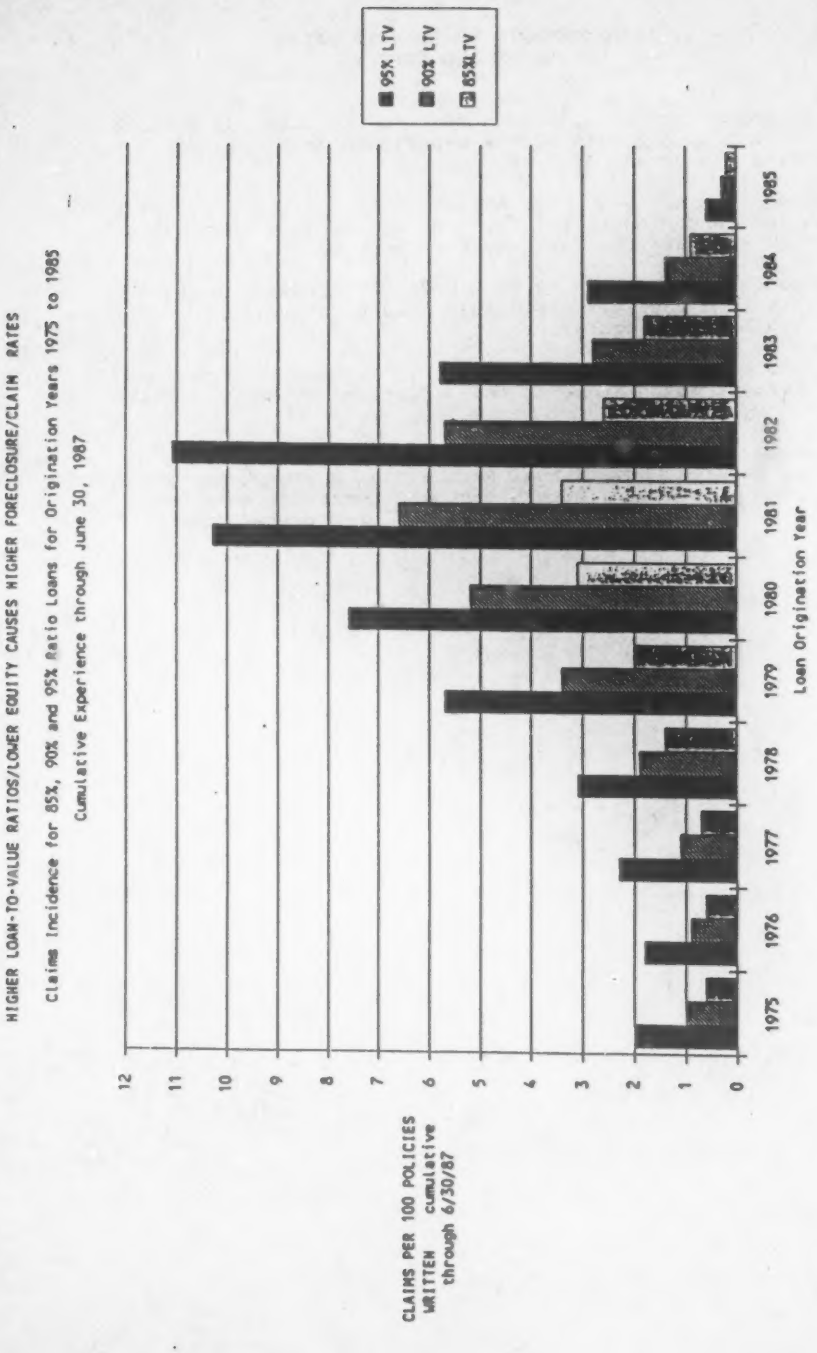
Dr. Irving Plotkin, 1975, "The Arthur D. Little Study of the Private Mortgage Insurance Industry;" This report examines the risk relationships within the mortgage insurance industry.

Kerry Vandell, 1978, "Default Risk Under Alternative Mortgage Instruments;" An analysis of default risk parameters by a Southern Methodist University professor.

Patric Hendershott, 1982, "Economics of Mortgage Terminations;" Implications of mortgage terms and conditions by an Ohio State professor.

Tim Campbell and Kimball Dietrich, 1982, "The Determinants of Default on Insured Conventional Residential Mortgage Loans;" A study of MGIC data impacted by future economic constraints by University of Southern California and University of Utah professors.

Appendix V


HIGHER LOAN-TO-VALUE RATIOS/LOWER EQUITY CAUSES HIGHER FORECLOSURE/CLAIM RATES
Claims Incidence for 85%, 90% and 95% Ratio Loans for Origination Years 1975 to 1985
Cumulative Experience through June 30, 1987
95% LTV
90% LTV
85%LTV
CLAIMS PER 100 POLICIES WRITTEN cumulative through 6/30/87
0
1
2
3
4
5
6
7
8
9
10
11
12
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
Loan Origination Year

BARRON'S April 24, 1989

Building Woes

The Federal Housing Administration May Be Headed for Trouble

By THOMAS G. DONLAN

WASHINGTON—In Oklahoma City, the local office of the Department of Housing and Urban Development stages a reenactment of the great Oklahoma land rush of 1889. In Denver, a more prosaic but equally desperate HUD office sponsors a Sunday advertising supplement in the Denver Post listing more than a thousand homes, with come-ons including $100 down payments on condos and $500 down payments on single-family houses.

These real-estate bonanzas are what's left of broken dreams. Some of the houses HUD is trying to sell were owned by families who dreamed of a better life. Others were owned by property speculators and crooks who dreamed of getting rich. All of them were insured by Uncle Sam, who paid off their mortgages when their dreams went bust.

The payments came from a major—and familiar—government agency, the Federal Housing Administration, which today insures $277 billion worth of mortgages on many of the nation's less-expensive homes. Born in the Great Depression, when a battered, default-shy banking system shunned lending for housing, the FHA pioneered the long-term, fixed-rate residential mortgage, and in other ways helped revolutionize housing finance. And it helped establish home ownership, through low down payments and affordable monthly outlays, as a realistic goal for Americans of modest means. All the while, FHA was, as far as the world could tell, functioning as a viable insurance operation, covering losses from a fund replenished not by taxpayers but by premiums collected from the borrowers themselves, and playing a role the private sector was unwilling or unable to fill. A classic New Deal success story, FHA is a legacy of that era that has survived a half century—and even the Reagan Revolution.

But now there are hints of trouble in this big federal insurance program. Indeed, FHA may be where federal insurance of savings-and-loan deposits was eight to 10 years ago, before fraud and foolishness mushroomed into a $100 billion crisis.

No one today is suggesting that the FHA is inevitably moving down the same path traveled by the now-bankrupt Federal Savings and Loan Insurance Corp. But the agency has been suffering losses in recent years—losses that threaten to enlarge the federal deficit. The result could be cuts in the program, or, more likely, an expansion of FHA's reach, and potential premiums, into the upper-middle-class housing market. Either way, the result could have profound impact on the housing industry.

The extent of FHA's troubles has been hidden from view. Its accounting doesn't conform to the accepted standards applied to insurance companies in private industry. And in violation of a statutory requirement that's been on the books since 1945, the FHA has never been audited. "Over the years, the place had become an absolute shambles," says a government auditor. "Nothing balanced, and our guys would just walk out. It was unauditable."

But over the past three years, a team of former employees of the General Accounting Office have been hosing out the financial stables of the FHA and the books are now said to be more or less presentable. Within a few weeks, the GAO expects to publish an audited version of the balance sheet for the fiscal year that ended Sept. 30, 1987. With that as a starting point, a full audit of the balance sheet and income statement for fiscal 1988—which ended last Sept. 30—may be ready for publishing this summer.

> "Over the years, the place had become an absolute shambles. It was unauditable."

It promises to be a revealing document. "When we started, the FHA had equity of $3.1 billion on the books, using the word 'books' loosely," says an official. The new balance sheet is expected to show the results of more than 60 major adjustments, which erased about $1.9 billion of purported equity, leaving $1.2 billion in equity to back $277 billion in mortgage insurance in force.

If FHA were a private mortgage insurance company, that kind of leverage on its balance sheet would be unacceptable, but FHA is ultimately backed by unlimited power to borrow from the U.S. Treasury. It is this borrowing power that allows holders of Ginnie Mae certificates to sleep at night, since most FHA mortgages are packaged into pools certified by the Government National Mortgage Association and sold to the public. In a two-tier security system, FHA actually insures the mortgage while GNMA insures cash flow by guaranteeing that principal and interest payments on Ginnie Maes will be made on time.

In the $1.9 billion FHA write-off, $350 million recognized existing losses and $500 million was for "miscellaneous" items. The largest adjustment, about $1.1 billion, created a reserve for future losses on the insurance portfolio based on past experience. One reason that FHA had gone unexamined for so long was that under the U.S. government's cash-based accounting system, FHA origination fees plus revenue from sales of foreclosed homes in any particular year always outweighed the insurance payments made in the same year. This wasn't much better than a Ponzi scheme, since the apparent health of FHA depended on its ability to insure new mortgages faster than the old ones went bad.

In a Ponzi scheme, large dividends are paid out of the victims' original cash investment, thus attracting new victims who are deceived into believing that the scheme is highly profitable. In government budgeting, a program does not contribute to the deficit as long as current revenues exceed current outlays, thus deceiving taxpayers and legislators.

In fiscal 1984, the FHA program reduced the federal budget deficit by $365 million, even while insurance claims paid were $1.7 billion and its direct losses on the sale of foreclosed assets were $529 million. For fiscal 1985, this governmental equivalent of a profit was tallied at $653 million, while claims ran $2.2 billion and losses on the sale of foreclosed assets were $601 million. The budgetary profit grew to $1.69 billion in fiscal 1986, against claims of $2.9 billion and losses on disposal of assets of $546 million.

The primary reason for these profits was rapid growth in insurance premiums and fees on new mortgages, from $906 million in 1984 to $3 billion in 1986. In other words, as the old joke has it, the FHA made it all up in volume, because its accounting did not recognize that new business would mean new claims and new losses in the future.

The current accounts began to show trouble in 1987, when

premiums began a downturn, to $2.8 billion, while claims rose faster than ever, to $4.4 billion, and loss on disposal of assets was $979 million. The FHA showed a budgetary loss of $188 million.

That was the first loss in FHA history, but officials said there was nothing to worry about. All that loss and more came from two relatively small housing-aid programs; the major program, called Mutual Mortgage Insurance, contributed a $101 million profit.

In 1988, premiums slumped again, to $1.9 billion, while claims rose again, to $5.9 billion and the direct loss on disposal of foreclosed assets hit $1.6 billion. Unaudited accounting by the Department of Housing and Urban Development, FHA's parent, shows FHA taking an $857 million loss, of which Mutual Mortgage Insurance was responsible for $368 million. The budgetary outlay was $1.1 billion.

This would seem like big money, were it not overshadowed by the pending $100 billion bailout of the FSLIC. The Senate Banking Committee, for example, recently canceled a hearing on FHA mortgage insurance so that its members could continue to wrestle with the savings and loan crisis.

(FHA is not the government's only troubled mortgage-insurance program, either. The Veterans Administration loan-guarantee program received a bailout of nearly $750 million last year, and looks to be in as deep this year. The Farmers Home Administration owns 1.3 million acres of farmland it received after paying claims on insured foreclosures.)

HUD consistently has put the blame for FHA's problems on regional depressions, most notably in the energy belt. Some HUD jokesters say they have simply a CLOT problem—meaning that the difficulties are confined to sinking real-estate values in Colorado, Louisiana, Oklahoma and Texas.

But closer examination shows that HUD has incurred heavy losses elsewhere—in Camden, N.J., where the market for homes has not been overheated for at least a generation, and Seattle, where there has been prosperity for more than a decade. And even in the troubled real-estate markets like the CLOT states, there is more to blame than just falling energy prices. Collapsing housing prices have typically provided opportunities for fraud, but HUD's lack of vigilance allowed the frauds to be successful.

Consider the practice known as "equity skimming." Oklahoma HUD manager Charles Ming says "kitchen table" real-estate deals are common in his city. A family with an FHA mortgage on a modest home finds the monthly payment too much to bear when the breadwinner is laid off. They put the house up for sale, offering to sell to any buyer who will assume the mortgage. "Unfortunately, the mortgage is now bigger than the value of the home on today's market, but 'Mr. Investor' goes out and offers to take it over," says Ming. Maybe, to enhance his image as a ruthless real-estate speculator, "Mr. Investor" insists that the owners pay him $1,000 to take the house and its mortgage off their hands. The family picks up stakes and heads for some place where jobs and hope may be found.

Behind them in Oklahoma City, "Mr. Investor" isn't really a speculator, but a crook. He doesn't record the deed; he doesn't assume the mortgage; he doesn't make monthly payments. He just sticks a "For Rent" sign in the front yard, rents the house and pockets the rent checks—often for a couple of years.

In a more devious variant recounted in a report from HUD's inspector general, a speculator lined up straw buyers to purchase 25 properties, using FHA-insured mortgages. Then the speculator acquired the properties by assuming the mortgages. Two years later, 10 of the loans were delinquent, nine were in default and three were in foreclosure.

This could not work if the lenders and their mortgage servicers kept close tabs on payments. According to HUD's critics, they don't. After all, these are loans that FHA guarantees will be repaid eventually; it makes more sense for the banks to work on loans where they are actually at risk. This scam also could not work if HUD kept reasonable tabs on the lenders and servicers. According to HUD's critics, it doesn't.

The General Accounting Office has issued a series of critical reports on FHA mortgage insurance. It has said over and over that HUD does a poor job of appraising properties and an even poorer job of reviewing appraisals. For example, a GAO check of three offices in 1986 found that more than three-quarters of appraisal reviews did not include a check inside the appraised home. The reviewers just drove by.

No wonder HUD's inspector general has been saying for years that "fraud and abuse in the Single Family Mortgage Insurance Program continues to be a significant problem for the department." Case studies in the inspector general's report show that the problem can be found all over the country, not just in the CLOT states. From the report for the six months ended March 31, 1988:

- A couple in Seattle used equity skimming to collect $200,000 in rents on 97 properties while making no mortgage payments. When the lenders foreclosed, FHA lost $425,000 on resale of 22 of the properties. The Veterans Administration, which has a similar mortgage-insurance program, lost $288,000 on 17 properties.
- Two officials of a Greenville, S.C., development company obtained FHA-insured loans on 10 properties and then allowed persons who could not qualify to assume the loans. Most of them defaulted, resulting in HUD losses of $317,000.
- A builder in Denver provided down payments to buyers who could not qualify, then built the cost into the home mortgages insured by FHA. After the local U.S. attorney refused to prosecute, HUD required the builder to take over the insurance liability.
- A ring of builders, a lawyer, a loan officer and a real-estate agent operating in Atlanta paid straw buyers $2,500 to apply for FHA-insured mortgages. False paperwork indicated the buyers had put down 15%. After the closings, the real purchasers assumed the mortgages, putting down little or nothing. At least 78 of them defaulted.

In fiscal 1987, 64,269 FHA-insured borrowers defaulted on single-family home mortgages and HUD made good on them, to the tune of $3.6 billion.

Among the peculiarities of the FHA program is the provision that the foreclosing bank conveys the property to HUD and receives the amount of the insured debt. HUD, not the lender, then incurs the costs of holding and selling the property, including property maintenance, repairs and local taxes. (The Veterans Administration loan program insures less than the total mortgage and leaves the property with the lender.)

HUD's ultimate loss depends on what its regional officials like Charles Ming can sell them for. The HUD inspector general has several times criticized the agency for allowing houses to be sold too cheaply; the GAO has criticized the department for not moving them quickly enough.

HUD's average holding period in 1987 was seven months. (The average acquisition period, which measures the time from the last payment to the time of the foreclosure, was 16.7 months.)

HUD's net loss in fiscal 1987 on selling 59,194 single-family homes was $1.2 billion. The department reported that the average holding cost was $4,000 per property, for a total of $236 million. To this, the General Accounting Office says, should be imputed an opportunity cost representing the interest lost from holding the properties—running about $2,200 per average property.

Some foreclosed properties are worth less than HUD's cost to foreclose on them and hold them. HUD often does it anyway. The General Accounting Office urged HUD to appraise properties to determine whether foreclosure is cost-effective. HUD officials said they would think about it. A payment-supplement program already exists but only for borrowers who have a temporary problem paying. (At the end of September 1987, there were more than 50,000 mortgages with outstanding balances totalling about $1.[illegible] billion in this program, which is called the Mortgage Assignment Program.)

GAO and the HUD inspector general's office have been making the same criticism of the FHA program for years. And fraud against the FHA started at about the same time as the FHA, more than 50 years ago. But the program has always been declared fundamentally sound—in need of better enforcement, perhaps, but a worthy program that poses no long term fiscal threat. Those declarations continue today.

HUD's actuary has declared the Mutual Mortgage Insurance Fund to be actuarily sound—that is, he calculates that the long-term income of FHA premiums and fees, plus investment interest, will be sufficient to cover the long-run cost of claims minus the proceeds on the sale of foreclosed assets. Price Waterhouse actuaries hired by the General Accounting Office said his assumptions were reasonable.

Peat Marwick & Main ran the FHA through a spreadsheet exercise that modeled the impact of economic stress on the insurance program. The firm said FHA deserved at least a rating of AA from S&P.

The Peat Marwick conclusion, however, is extremely generous. It turns out to be based on "parental support" from the U.S. Treasury (presumably an AAA credit). It covers only the Mutual Mortgage Insurance program. That is 85% of the FHA's business, but excluding the other 15% excludes more than half the FHA's losses. In addition, Peat Marwick's starting point was the 1987 balance sheet as it appeared before the GAO audit that's about to be published, so it overstates the MMI equity by about $1 billion. Elsewhere in the Peat Marwick report, the careful reader learns that Peat Marwick expects that even the Mutual Mortgage Insurance Fund will run operating losses for the next three years under current economic assumptions, with bigger losses lasting longer if the economy turns down. In the regional-recession scenario, the fund would be exhausted in four years; in the national-depression scenario, it would take only three years.

At bottom, the Peat Marwick report of the FHA's good health really depends on the U.S. Treasury. "It appears that the MMIF cannot meet Peat Marwick's interpretation and application of the tests of survivability by Moody's and S&P without 'parental' support from the U.S. Treasury," the report says. Then it asks, in effect, so what? "Many (and perhaps all) of the private mortgage insurers who have achieved the rating agencies' highest ratings did so only on the strength of parental support and other capital maintenance agreements," notes the report. At bottom, says Peat Marwick, "the MMIF is in a strong financial position."

Responsible officials and legislators have apparently read no further than this statement. In fact, leaders of the Senate Banking Committee want to expand the FHA program to help more people.

Chairman Alan Cranston of California and the committee's ranking Republican, Alfonse M. D'Amato of New York, are pushing a bill that would cut required FHA down payments and repeal the $101,250 limit on size of the mortgage that could receive FHA insurance. FHA mortgages would be available in amounts up to 95% of the median house price in each state or smaller region designated by HUD. Down payments could be as low as 3% for first-time home buyers who go through a counseling program.

The justification, especially for the senators from California and New York, is that home prices in many areas, including parts of their own states, have outpaced the FHA limit. The bill, said Cranston when he introduced it last month, "will make low down payment FHA mortgages available equitably throughout the country."

But the flexible mortgage ceiling means FHA insurance will be available on mortgages of about $200,000 in some areas. Income qualifications dictate that the beneficiaries of government insurance will include people making more than $75,000 a year.

"We are still covering only the modest-cost houses, relative to the local markets," says an aide to the Senate Banking Committee. "We're just going to stop freezing out whole markets. You have to ask, 'Do we have a national program or a regional program?' Are you going to say that modest houses for people with modest lives in L.A. are excluded? Their salaries may be higher but their cost of living, and of housing, is certainly higher. Their standard of living is similar to a lower income somewhere else."

Some housing experts say the government ought to concentrate its aid on poor people. "In Orange County, Calif., we are talking about using FHA mortgages to buy $200,000 homes," says Anthony Downs, a housing economist at the Brookings Institution in Washington. "I don't think this is the group that needs help. And anyway, California and the Northeast have created their own high market with anti-growth policies, such as restrictions on multi-family buildings. Why should the rest of the country subsidize their refusal to create enough housing?"

Another argument comes from the private mortgage-insurance companies, which see FHA as a potential competitor. William H. Lacy, president of Mortgage Guaranty Insurance Corp., predicts that raising the limit will actually harm lower-income buyers. "One $200,000 loan will crowd out four $50,000 borrowers," he says. In addition, he says, easier credit will drive up the price of homes everywhere, with the indexed FHA mortgage ceiling following right along: "It would be inflationary as hell. Upper-income people will grab onto FHA right away."

The insurance holds the interest rate down, and FHA loans are assumable. Says Lacy: "When FHA financing becomes available to people like myself, I'll bid up the price when I want to buy. And when I sell, I'll ask more because of the assumable mortgage."

Lacy is also chairman of his trade association, the Mortgage Insurance Companies of America, which proposes to target the benefits of FHA insurance to borrowers based on income, rather than on the prices of houses in the region. That probably won't satisfy Cranston and D'Amato and their constituents.

Nor will it satisfy the National Association of Home Builders, the Mortgage Bankers Association and other housing industry lobbyists who support the Cranston-D'Amato bill. They support adding liquidity in hot real-estate markets, and they contend that raising the FHA ceilings will strengthen the Mutual Mortgage Insurance Fund because upper-income borrowers are more reliable. Lacy and other opponents argue that low down payments will attract the least reliable upper-income borrowers, further endangering the MMI fund. The General Accounting Office has been asked to review the controversy.

Hearings on the FHA amendments are likely to be held this summer. In both houses of Congress, the FHA provisions are part of much larger housing bills that Democrats hope will rejuvenate programs for public housing and aid to the homeless that were reduced under the Reagan administration. That gives the FHA amendments a high priority and a fair chance of passage by the end of the year.

Though it would take a great deal of mismanagement and fraud and inattention to bring the FHA program down to the level of the FSLIC, it is noteworthy that the committees considering the housing bills are the same panels that crafted savings and loan deregulation in the early 'Eighties. ■

Mortgage Insurance Companies of America

Steven P. Doehler
Executive Vice President

June 27, 1989

The Honorable Cranston
United States Senate
112 Hart Senate Office Building
Washington, DC 20510

Dear Senator Cranston:

On page 57 of the transcript of my testimony before the Housing Subcommittee, I indicated that the Mortgage Insurance Companies of America (MICA) had more recent data on the industry's claims experience based on loan amount. I have attached two tables which update Appendix VII and Appendix VIII to my written statement.

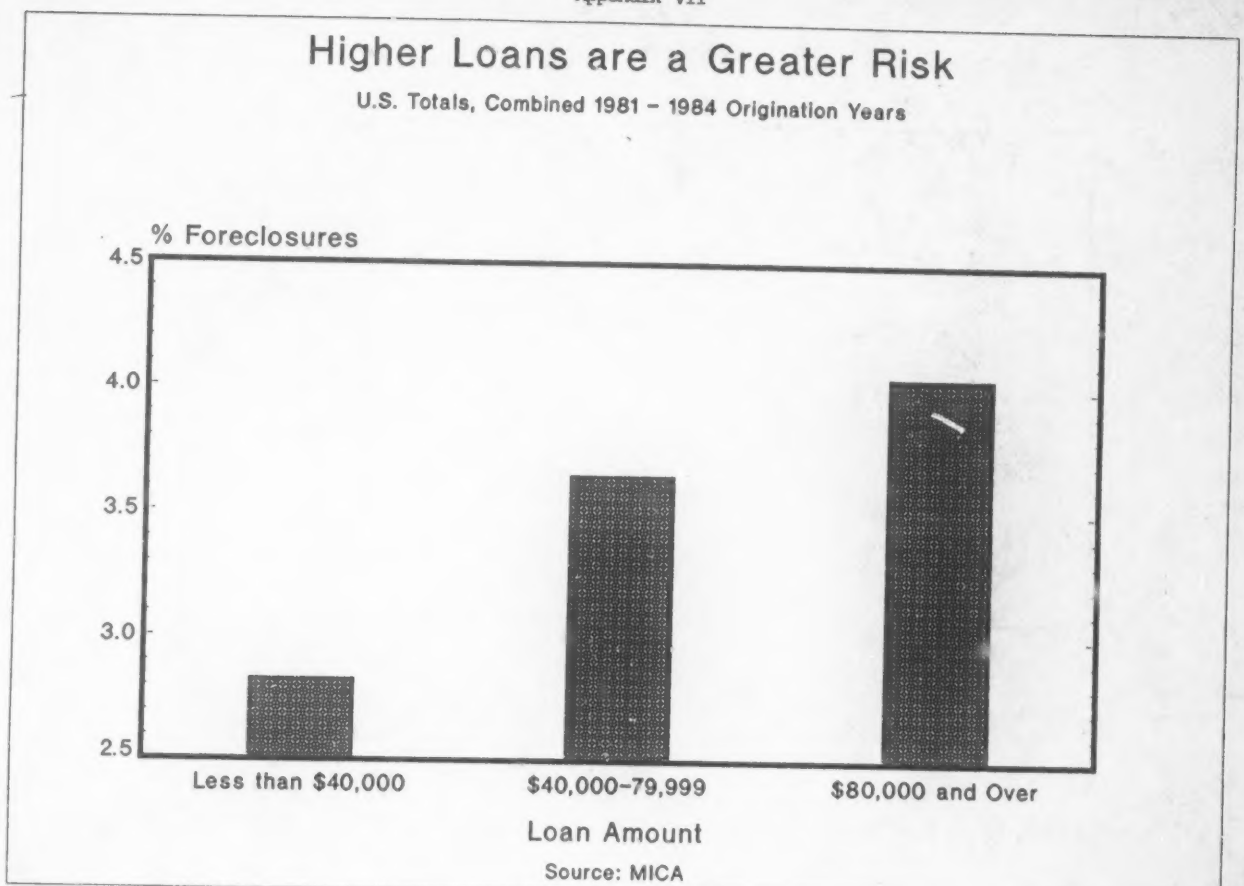
These two tables show the three-year claim rates on all privately-insured loans originated in 1981 through 1984 by loan amount. Loans over $80,000 had a higher probability of going to claim than smaller loans. In addition, loans over $80,000 with 90 and 95 percent loan-to-value ratios had a higher probability of going to claim than smaller loans with the same loan-to-value ratios. Loans with 95 percent loan-to-value ratio had a much higher incidence of claims than loans with a 90 percent loan-to-value ratio in all loan amount categories. Early indication show the same trend for privately insured loans originated in 1985 through 1987.

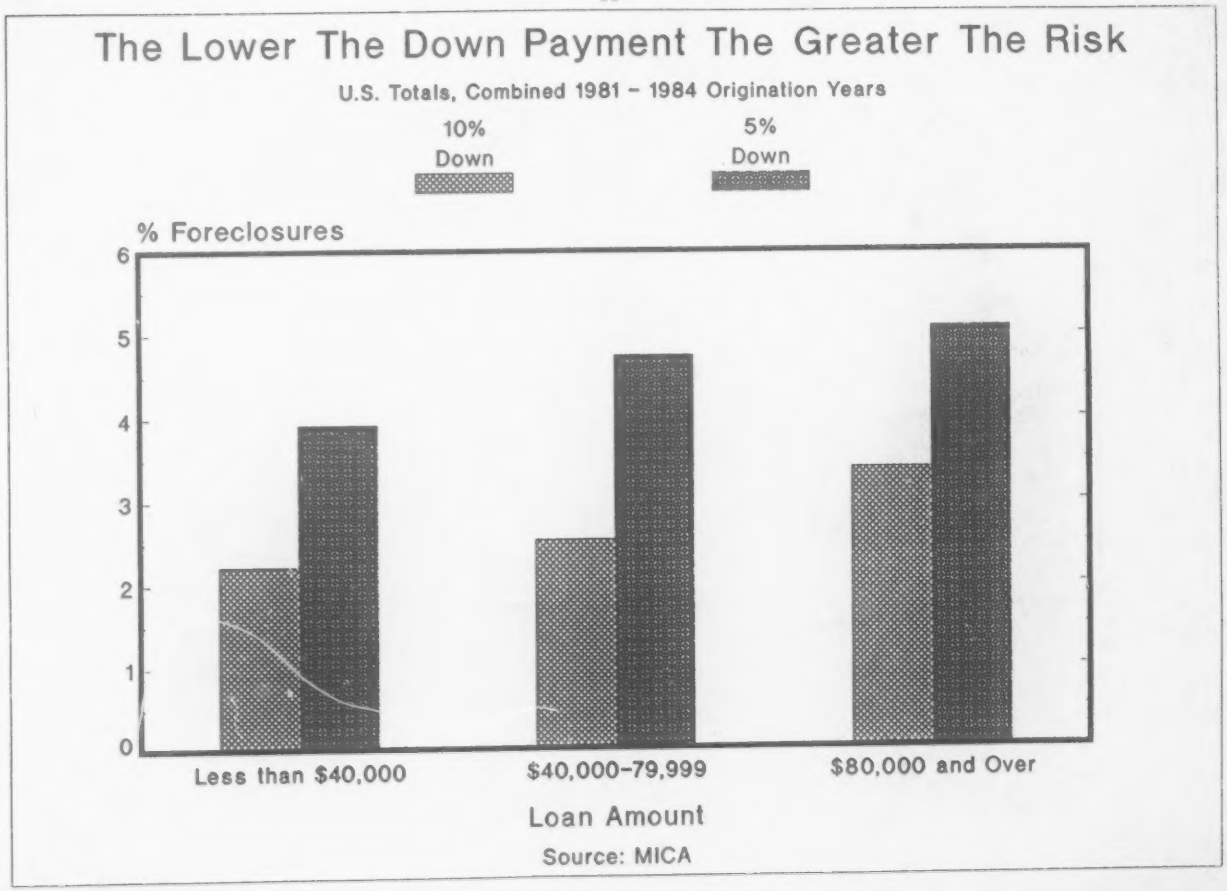
I hope you will include this information in the record.

Sincerely,

William H. Lacy

805 15th Street, N.W.
Suite 1110
Washington, DC 20005
(202) 371-2699
Fax (202) 371-2675


Higher Loans are a Greater Risk
U.S. Totals, Combined 1981 - 1984 Origination Years
% Foreclosures
4.5
4.0
3.5
3.0
2.5
Less than $40,000
$40,000-79,999
$80,000 and Over
Loan Amount
Source: MICA


The Lower The Down Payment The Greater The Risk
U.S. Totals, Combined 1981 – 1984 Origination Years
10% Down
5% Down
% Foreclosures
6
5
4
3
2
1
0
Less than $40,000
$40,000–79,999
$80,000 and Over
Loan Amount
Source: MICA

HOME OWNERSHIP MADE EASIER (HOME) PROGRAM

Today there are two fundamental problems facing low to moderate income first time homebuyers — accumulating a downpayment and making the monthly mortgage payment. The Federal government has a role to play in alleviating these affordability problems. However, any solution must involve a partnership between the public and private sector and must have a negligible impact on the Federal budget.

To achieve these goals, we propose the Home Ownership Made Easier Program or HOME Program. The HOME Program would combine both Federal and private resources to put people into homes. Equally important, it would require potential homeowners to work toward and save for their homes. It is structured so the homebuyer would have equity in the property and achieve the dream of homeownership in a shorter, more realistic period of time than is currently possible.

Under the HOME Program, eligible first time homebuyers would be able to deposit funds in special savings certificates and these personal funds in turn would be matched by the Federal government. The amount of Federal matching funds would depend on the homebuyer's income. The participants would be able to use these funds for expenses associated with a mortgage loan, including the downpayment, closing costs or to buydown the interest rate. The homeowner would repay the Federal government the funds it contributed to the certificate. A secondary market would be established for some of these loans.

The following are the specific aspects of the HOME Program:

1. *First time homebuyers (anyone who has not owned a home in the last three years) would be able to contribute to "HOME Certificates" by depositing funds into a depository institution which would act as the agent for the Federal government. The funds would be administered by the Department of Housing and Urban Development.*

2. *The Federal government would contribute to the certificates in an amount dependent on the income of the first time homebuyer. The following illustrates how the Federal contributions would work:*

% Median Household Income*	Borrowers Contribution	Government Matching Share Per $1.00 Contribution	Total HOME Certificate Amount
≤ -50%	$1.00	$4.00	$5.00
51–80%	$1.00	$3.00	$4.00
81–100%	$1.00	$2.00	$3.00
101–120%	$1.00	$1.50	$2.50
Over 120%	Not Eligible		

* *Median income tables would be made available through the Department of Housing and Urban Development.*

First time homebuyers with incomes above 120 percent of the area's median income would not be eligible for this program.

3. *If a first time homebuyer's income were to go above 120 percent of the area's median income, he or she would no longer be able to participate in the program. However, they would be able to use the existing personal and Federal funds in the certificates to purchase a home subject to all the conditions of the program.*

4. *Borrowers would receive five percent interest on the money contributed to the certificates.*

5. *The total amount that the borrower would be able to contribute to a certificate in any one year is five percent of his or her income. The total amount of the certificate, including the government's contribution, could not exceed 50 percent of the area's median income. To help first time homebuyers immediately after the program begins, the requirement of five percent of income per year could be phased in over three years. In year one, a first time homebuyer could contribute up to 15 percent of his or her income; in year two, ten percent; and year three and from then on five percent. The 50 percent of median income cap, however, would still apply.*

6. *The government's contribution to the borrower's certificate would vest depending on the length of time the borrower is in the program. If the borrower decides to purchase a house after being in the program only one year, he or she would only receive 25 percent of the government's matching fund; after two years 50 percent; and after three years or more, the full amount of the government's matching contribution.*

7. *Borrowers would be required to purchase their home within seven years of making their first contribution to a certificate. If borrowers withdraw from the program without purchasing a home, they would receive only the funds they contributed, plus the interest. They would not receive the government's matching funds.*

8. *A home purchase certificate would be issued to eligible participants at the time they purchase their home in an amount equal to the participant's contribution, plus the government's matching share. The participants would receive a statement at the end of each year stating the amount they contributed and the amount of the Federal match for that year, based on their income for the year.*

9. *The borrower could use the certificate to purchase any home using either conventional or Federally insured or guaranteed financing. The certificate would be used for expenses associated with a mortgage loan. The borrower would simply present the certificate to the lender at closing and the lender in turn would redeem it for its face amount.*

10. *The maximum loan to value ratio for a loan using funds from this program would be 95 percent.*

11. The Federal government would receive a second lien on the property for an amount equal to its contribution to the certificate.

12. Borrowers would be required to pay back the amount contributed to their certificates by the Federal government. Payments to the government would begin immediately after the home is purchased. Borrowers earning less than 80 percent of the area's median income at the time they purchase their home would pay three percent interest on the second lien, amortized over the life of the first lien. Borrowers earning between 80 and 120 percent of median income would pay nine percent.

13. A secondary market for the second mortgages to purchasers earning between 80 and 120 percent of median income would be established.

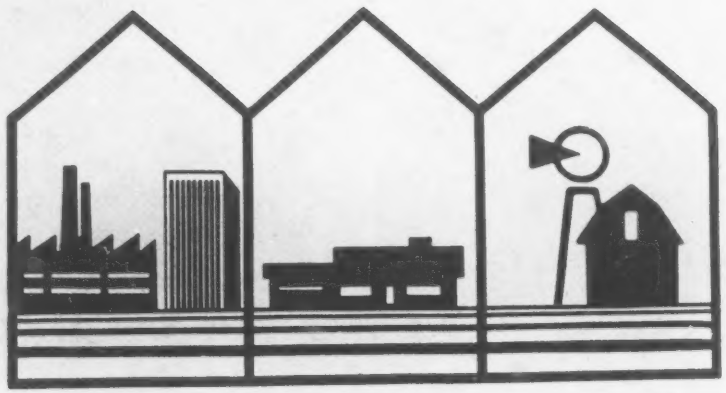
14. If the borrower sold the property, the amount owed to the government would be due in full. If the proceeds from the sale of the house were insufficient to pay back the government then the unpaid balance would be considered an unsecured obligation of the borrower.

15. The servicer for the first lien also would service the second lien for the government. The servicer would receive a 50 basis points servicing fee, which would be taken out of the interest rate paid by the borrower.

16. The program would sunset four years after it is started. This means that potential homeowners would have to begin to make their contributions before the four years expires in order to be eligible to receive government matching funds when they purchase a home.

The vital element of the HOME Program is that it focuses on borrower income and those in our society with the greatest need. It will not help high income individuals or those seeking to trade up from one house to another. The focus is not on house prices. The program stretches further by as much as 11 to 26 percent the capacity of a household with a modest income to qualify for homeownership. The HOME Program requires action by the potential homebuyer, service by the private institution, and commitment by the government.

In addition, the HOME Program has minimal impact on the Federal budget. Monies are constantly flowing into the program in the form of contributions by potential homeowners, sales of the second mortgages on the secondary market, and repayment of second mortgage loans. The HOME Program is projected to ultimately make money for the government. It will have a net negative cash flow for only four years and then the cash flow will be positive. By the time the program sunsets, it will have helped 500,000 deserving families purchase homes. The program is an efficient way to leverage Federal funds.



Statement of the

NATIONAL ASSOCIATION OF REALTORS®

THE WORLD'S LARGEST TRADE ASSOCIATION

TO: SENATE SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

ON: THE NATIONAL AFFORDABLE HOUSING ACT

BY: IRA GRIBIN, PRESIDENT

DATE: JUNE 9, 1989

STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

OF THE

U.S. SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

BY

IRA GRIBIN

PRESIDENT

JUNE 9, 1989

INTRODUCTION

Mr. Chairman, my name is Ira Gribin. I am a REALTOR® from Encino, California, and I am the President of the NATIONAL ASSOCIATION OF REALTORS®. On behalf of the members of the NATIONAL ASSOCIATION OF REALTORS®, I would like to thank you and the Members of the Subcommittee for your commitment to promoting affordable housing opportunities for our Nation's citizens, and for this opportunity to testify on S. 565, the National Affordable Housing Act. The NATIONAL ASSOCIATION OF REALTORS® has the largest membership of any association in the United States, with close to 800,000 members representing all facets of the real estate industry including residential and commercial real estate development, mortgage banking, home building, property management, appraisals and syndication.

This Subcommittee, particularly Senators Cranston and D'Amato, along with their fine staffs, has worked very hard to identify the housing needs faced by our country and to produce legislation to address these needs. I commend all those who have been involved in this effort for their fine work and impressive results.

The cumulative effect of the Rouse-Maxwell Task Force, the Task Force's National Housing Policy Advisory Panel, for which I had the opportunity and the privilege to serve as Co-Chairman, and the hearings and discussions which this Subcommittee has overseen is a clear consensus on the need for action and a strong momentum toward producing such action. This bill is now the focus of that momentum, and I hope that my comments will help define the need for such legislation, describe the position of the NATIONAL ASSOCIATION OF REALTORS® regarding this bill, and point out a few areas where the bill might be strengthened.

HOMEOWNERSHIP

A decline in overall homeownership rates from 1980 to 1988 marks a reversal of the long-time trend of growth in this area. This general decline represents the first sustained one of its kind since the 1930s. Although the homeownership rate rose slightly in 1987, it subsequently declined in 1988, leaving it significantly below its peak at the beginning of the decade.

In general, this reversal can be attributed to home prices which have risen faster than income over the period of 1973-1988, increasing buyer

difficulty in meeting downpayment and closing costs and higher mortgage payments. Specifically:

- Between 1973 and 1980, house prices rose 115 percent nationally, while median family money incomes rose 75 percent. Moreover, over the same period, median incomes of first-time homebuyers rose by only 52.3 percent. From 1980 to 1988, first-time homebuyers' incomes rose faster than house prices (49 percent vs. 31 percent); but this reversal is not nearly enough to close the gap created by the developments of the 1970s.
- The actual decline in the homeownership rate between 1980 and 1988 has been from 65.6 percent of households to 63.9 percent; this is the first sustained decline in the homeownership rate ever. In states which have relatively high housing costs, the drop in homeownership has been even more dramatic.
- Based on published data, it can be estimated that there are almost 2 million fewer homeowners today than there would have been if the 1988 homeownership rate had been maintained at the 1980 level.

Housing Affordability

There are a variety of methods available to measure housing affordability. These include: (1) the ratio of current housing expenses to current household income, (2) the ratio of median sales price to income, and (3) the percentage of households able to purchase the median priced home. Whichever measure is used, there are three primary factors affecting housing affordability that need to be examined: housing prices, income, and mortgage interest rates.

Several years ago, the NATIONAL ASSOCIATION OF REALTORS® began monitoring the affordability of housing by developing a Housing Affordability Index. The index includes the median prices of resale homes and mortgage interest rates

and compares the resulting mortgage payment on an 80 percent loan to the ability of the median income household to carry the loan.

Under the index, housing was most affordable in 1972 when median family income was nearly 55 percent above the minimum required to carry the mortgage. From that point, affordability declined consistently, hitting bottom in 1982 when the median-income family had less than 70 percent of the income required to carry a standard mortgage on the median priced home. Generally declining mortgage rates after 1982 combined with moderate home price increases to allow the index to rise by approximately 63 percent over the period between 1982 and 1988.

While the ASSOCIATION's composite index indicates that affordability has increased, it does not reflect the fundamental problems which exist in the first-time homebuyer segment of our population. As I will discuss in more detail later, first-time homebuyers, typically adults in the 25- to 34-year old category, face the most difficulty in realizing the goal of homeownership. The Association's First-Time Homebuyer Affordability Index, which bases its mortgage loan amount on a 10 percent equity downpayment, "first-time homebuyer" median incomes and median prices on starter homes, indicates that, while the plight of first-time homebuyers has improved since 1982, first-time homebuyers' incomes are still over 20 percent below what is required to purchase a starter home. As evidence of the affordability problems of first-time homebuyers, I'd like to point out the correlation between the decline in the home price-to-income ratio for first-time homebuyers, and the overall decline in the homeownership rate.

As a measure of affordability, the decline in the home price-to-income ratio means that the "typical" first-time homebuyer is unable to purchase the "typically" priced home.

Rising Home Prices

Home prices have increased quite rapidly in recent years. For the U.S. as a whole, the median priced existing single-family home in 1970 was $23,000. By 1988, the median priced home had risen to $89,300, a 288 percent increase! In California, the increase is far higher due to a combination of a high level of demand and tight supplies, as building activity has been constrained by high land costs and anti-growth measures. As a result, the median priced existing single-family home in California shot from $24,300 in 1970 to $168,560 in 1988 -- a 594 percent increase!

California is not the only place where housing prices have sky-rocketed. Unfortunately, reliable statistics are not available for most areas prior to 1980. However, nationwide housing prices have risen 27 percent in the last five years. In many places this national rate of increase has been surpassed by a large margin. In the New York/Northern New Jersey/Long Island metropolitan area, where nearly 18 million Americans live, home prices have more than doubled in the last five years. Similarly, in greater Boston, the median home price has doubled in the last four years alone. Home prices have also increased by at least 50 percent in the last five years in the Hartford, Providence, Albany, Rochester and Syracuse metropolitan areas.

22-940 O - 90 - 6

Incomes Have Not Kept Pace

Incomes over this time increased too, but not as rapidly. According to the U.S. Bureau of the Census, "Current Population Reports," median family income in the U.S. over the same 1970 to 1987 period increased 213 percent from $9,867 to $30,850, compared to the corresponding 272 percent increase in housing prices.

While the changes are somewhat less dramatic when you look at changes during the 1980s, clearly many communities continue to have housing costs increasing much more rapidly than local residents can absorb. In the Boston area, for example, home prices have doubled in the last four years, while median family income has increased by one-third as much as home prices.

There is also evidence that affordability will continue to be a problem in the future when the incomes of renters and homeowners are compared. Census data show that the 1988 median annual income among renting households was $15,900, or only 49 percent of the $32,300 median among homeowning households. Renters not only have lower incomes than homeowners, in general, but the income of renting households has been rising more slowly than that of homeowning households. From 1980 to 1988, median incomes rose 51 percent among renters but 63 percent among owner occupants. While part of this gap was caused by the shift of some renters to homeownership between these two periods, it does not speak well for homeownership trends in the future as more and more renters find that their income growth fails to keep pace with the rising costs of homes.

First-time Homebuyers

Aside from the home price, income and financing constraints faced by prospective homebuyers, there is also the question of a buyer's ability to make the required downpayment. Those who already own a home and sell it to buy another have enjoyed home value appreciation and can use this gain as the downpayment on another home. For those who purchased before the huge rise in housing prices which began in the mid-1970s, these gains may be substantial, and repeat buyers can often avoid the increasing wealth constraints to housing affordability.

First-time homebuyers, however, are not so fortunate. It is this segment of our population who face increasing barriers to realizing their goal of homeownership about whom we are most concerned. It is to this area that the ASSOCIATION asks the Subcommittee to give particular attention.

Prospective first-time homebuyers tend to face both downpayment and income constraints. They are, most often, younger households who have yet to accumulate substantial savings for a downpayment and are at the lower end of their income earning curve. Data collected by the NATIONAL ASSOCIATION OF REALTORS® provides evidence of the difficulties faced by first-time homebuyers. All around the country, first-time homebuyers purchase significantly less expensive housing than repeat buyers -- $88,700 compared to $140,700 in 1988. First-time homebuyers also have lower annual median incomes; $37,700, compared to repeat buyers, who typically earn $54,000 per year. First-time buyers average lower sales-price-to-income ratios,

purchasing housing valued to 2.35 times their income compared to 2.61 times recorded for repeat buyers.

In addition to purchasing less expensive homes, first-time buyers make significantly smaller downpayments than repeat buyers. On a national basis, first-time homebuyers' downpayments in 1988 were significantly less, averaging $12,600 compared to repeat buyers' average downpayments of $40,500. Across the country, median loan-to-value ratios for the first-time buyer segment amounted to 89.7 percent, as opposed to 76.8 percent for the repeat buyer category.

Affordability problems confronting first-time buyers are also reflected in the types of housing they purchase. Compared to repeat buyers, the first-time buyer is more likely to purchase a smaller home with fewer bedrooms, and is more likely to purchase a condominium as opposed to a single-family detached home.

What all this data on first-time homebuyers signifies is that this part of our population is being severely restricted by the market, and that they are effectively under-housed because of their inability to purchase the typically priced home. Furthermore, the loss of this group, potential first-time homebuyers, represents the most serious threat to housing markets. The homeownership rate of 25 to 34 year olds in 1988 was 45.0 percent of households, a decrease of 7.3 percentage points from the 1980 level of 52.3 percent.

EXPANDING HOMEOWNERSHIP OPPORTUNITIES

Fortunately, the Federal Government can take steps to reverse this trend of declining homeownership rates. The National Affordable Housing Act recognizes this and proposes to improve the Federal Housing Administration's (FHA) mortgage insurance programs and make other changes to increase homeownership.

The Federal Housing Administration (FHA) is an extremely successful government program. The FHA program is a logical place to begin to address homeownership problems among first-time homebuyers because first-time homebuyers and low- to moderate-income homebuyers are precisely the population that the FHA program serves. As the following points demonstrate, the FHA program serves borrowers who have lower annual incomes, make smaller downpayments, and purchase lower value homes than homebuyers who utilize private mortgage insurance.

- According to the 1984-1988 Residential Mortgage Finance Panel (RMFP) surveys conducted by HAR, first-time homebuyers accounted for 72% of all FHA business in 1988. The survey data shows that the percentage of FHA borrowers who are first-time homebuyers has been increasing each year since the percentage stood at 43% in 1984.

- The FHA program serves homebuyers with a low median income. According to the HAR RMFP surveys, the median income of a FHA buyer as a percentage of the U.S. median family income ranged from 126.4% in 1984 to 109.3% in 1987. However, the median income for buyers who used private mortgage insurance ranged from 154.4% of U.S. median family income to 146%.

- The FHA provides proportionally more low downpayment loans to lower-income homebuyers, and proportionally fewer low downpayment loans to higher income homebuyers than do private mortgage insurers (PMIs) by a significant margin. According to 1986 RMFP data, 10% of FHA low-downpayment loans went to families with incomes of less than $25,000, and 23% went to families with incomes greater than $40,000. By contrast, only

1% of PMI low-downpayment loans were made to families with incomes of less than $25,000, while more than 56% of PMI low downpayment loans were made to families with incomes of greater than $40,000. According to a recent Congressional Research Service study, 60% of the loans insured by the FHA in 1987 were made to borrowers making downpayments of 10% or less, while nearly 77% of PMI loans were made to borrowers making downpayments of 10% or more. Furthermore, about 40% of the FHA low-downpayment loans were made to borrowers making downpayments of less than 5%, loans which the PMI industry does not generally accept.

- FHA users typically buy less expensive homes than borrowers who use conventional financing. According to a recent Congressional Research Service report, 49% of FHA loans in 1987 were for less than $60,000, while about 29% of PMI loans were in this category. Conversely, about 71% of PMI loans were for amounts above $60,000, while 51% of the FHA loans fit in this category.

- FHA loans are more affordable to homebuyers than conventional financing. NAR analyzed the interest rates on first mortgage loans by mortgage insurer type for all loans and for loans of $90,000 or less in the NAR database. For the averages of all loans, the interest rate difference between PMI loans and FHA first mortgages ranged from a low of 22 basis points in 1987 to 79 basis points in 1984. This pattern was also true when the loan amount was held at $90,000 or less for both PMIs and FHA. Furthermore, a Peat Marwick study indicates that the premium on a 30-year, greater than 95% LTV ratio, fixed-rate mortgage (comparable to an FHA loan) is 5.7% in the private market, compared to the FHA's 3.8% fee. In 1988, these high LTV ratio loans constituted about 73% of the FHA's new first loans in California.

As this data shows, the FHA has been an effective institution, providing American homebuyers with access to financial capital for homebuying. The FHA's mortgage insurance programs have enabled millions of homebuyers to obtain mortgages. However, as the Rouse-Maxwell Task Force reported, FHA maximum mortgage limits have not kept pace with increases in home prices in many areas. FHA loan limits no longer reflect the costs of homes in certain areas. Where housing costs are substantially higher than the existing FHA limit, homeownership is put out of reach for many borrowers who cannot qualify for conventional financing.

The current statutory maximum mortgage limit is $101,250, which is not high enough to purchase a median priced home in many metropolitan statistical areas in this country. In these areas, the loan limit is constraining the ability of moderate income homebuyers to obtain financing for home purchases. For instance, the FHA maximum limit applies to most of California, much of New York and Maryland, and significant areas of Tennessee, Texas, and Nevada. HUD has set the limit at the maximum for three entire states -- Massachusetts, Connecticut, and Rhode Island. It is very likely that many moderate income homebuyers who need FHA assistance cannot obtain it in these markets.

Partially as a result of home prices escalating beyond the FHA maximum mortgage limit in many areas, the FHA market share as a percentage of the total mortgage market is declining, from almost 14% in 1986 to less than 9% in 1988. We believe that part of the decrease in FHA's market share is due to the fact that the maximum mortgage limit has made the program less available in high-cost areas.

The price appreciation in high cost areas and the rigid FHA limit results in gross regional inequities. Out of the 14 areas with the largest gap between median home prices and the FHA loan limit, 5 are in California and 8 are in the New England or Mid-Atlantic regions. Further evidence of regional inequality is shown by the fact that in 1988 only 3.6% of new first mortgages in Orange County, 3.3% in Los Angeles County and just 1.3% in the San Francisco Bay Area were FHA-insured. Moderate-income and first-time buyers in the state's major employment centers are virtually precluded from taking advantage of FHA's low downpayment, low closing costs and other benefits.

The NATIONAL ASSOCIATION OF REALTORS® is pleased to see that the National Affordable Housing Act includes a provision to raise the current maximum mortgage limit by permitting the FHA to insure mortgages with values up to 95% of the median sales price of an entire state or for a substate area, where appropriate. Raising the FHA insurance limit to 95 percent of area median home price will accomplish three goals. First, it will make the program more flexible in terms of reflecting differences in housing costs among various areas. By making the limit a percentage of the area median price instead of a flat, across-the-board price limit, first-time buyers will be able to utilize the program in high housing cost areas. In California, for example, the California Association of REALTORS® has estimated that the change in the loan limit will almost triple the number of California home loans that could potentially qualify for lower downpayments under the FHA program. Under the current limit, an estimated 23 percent of all mortgage loans taken out by California buyers during 1989 would qualify for the program. NAR's analysis shows that, nationwide, raising the mortgage limits to 95% of the area median sales price and keeping the minimum limit at $67,500 would yield an additional 100,000 to 105,000 in FHA-insured sales, with 60,000 to 62,000 of these sales to first-time homebuyers.

Second, setting the limits at 95% of area median sales price without an absolute cap will make the FHA program responsive to changes in home prices over time. Many areas of the nation have experienced rapid appreciation in home prices over the last several years. Because of the flat dollar limit on the FHA insurance program, fewer and fewer homes in these areas of rapid appreciation are sold at prices within the limits of the program. With a

limit based on the percentage of the area median, access to the FHA program remains fairly constant as local housing conditions are more realistically reflected over time as homes appreciate in value. The 95% of median cap will still target FHA financing to the lower half of the ownership housing market in each area.

Third, raising the maximum mortgage limit will help broaden the usage of the program not only in terms of serving borrowers in more areas but also in terms of the range of borrowers who would buy homes that could qualify under the program. Consequently, FHA will be able to obtain a more diversified portfolio of loans in order to minimize risk.

This is important because the FHA insurance program is expected to operate as a viable, self-sustaining program. In order to remain self-sustaining, the FHA needs to be able to diversify its risks among regions and among different types of buyers. A study of the FHA program by HUD showed that FHA's claims rate tended to be higher in areas where housing appreciation is low and unemployment high. Therefore, raising the maximum mortgage limit will probably help the fund because the areas where access to the FHA will increase because of higher maximum mortgage limits are strong economic areas with lower incidence of default than economically depressed areas. Moreover, the incidence and the severity of loss is lower in strong economic areas than in weak economic areas. Thus, the loans insured by the Fund will be less likely to default and, therefore, help keep the Fund actuarially sound.

One potential problem in setting State limits is the difficulty in collecting home sales price data at the state level. Currently, home sales price data is collected for some metropolitan statistical areas, and sometimes for particular counties. This limited data cannot be used to determine accurate state level information. Therefore, Mr. Chairman, we recommend that this bill require HUD (or its designee) to collect county level sales price data, which could be aggregated to a metropolitan and state level. Inadequate data makes it more difficult to develop the information necessary to make policy decisions about local FHA limits and national policy. This legislation provides an excellent opportunity to dramatically improve the quality of home sales price statistics in this country.

In addition, we believe that it is appropriate for HUD to conduct an annual review of national homes sales price data to determine which areas are eligible for designation as high cost areas. There is no mandated review under the current system, which relies on petitions at the expense of the area applying for high cost designation. An annual review by HUD would be relatively easy to perform if the county level information were being collected already. Of course, areas should still retain the right to petition for high cost designation, but HUD should implement a better system for conducting its own review.

Mr. Chairman, I know that you are familiar with the difficulties first-time homebuyers face in trying to accumulate enough money for a downpayment on a house. That is why the National Affordable Housing Act would reduce downpayment requirements under the Federal Housing Administration (FHA)

homeownership assistance programs to 3% of the first $50,000 of a mortgage and 5% of the remaining mortgage balance instead of 3% of the first $25,000 and 5% of the amount exceeding $25,000. Furthermore, the Act allows the FHA to insure mortgages where a homebuyer makes a downpayment of 3%, provided that the homebuyer receives homeownership counseling.

The NATIONAL ASSOCIATION OF REALTORS® supports these changes because they should help many potential homebuyers who cannot currently take advantage of the FHA program because they cannot save enough money to make a downpayment. These provisions recognize this fact and offer significant assistance to these households. In the bill's definition of a "first-time homebuyer" however, the language suggests that an individual's eligibility could be affected by the status of a spouse who had at one time owned a home. We believe that this language is unnecessarily restrictive, especially given the possibility of divorces and remarriages where one spouse's previous ownership interest in a home should not disqualify the other spouse from participating in a first-time homebuying program.

Based upon the commonly-held view that high loan-to-value loans are more likely to default than low loan-to-value loans, the changes lowering downpayment requirements may lead to the origination of more risky loans. However, the changes proposed in Cranston-D'Amato are modest enough that we do not believe that their added risk poses any significant danger to the FHA Fund, which is actuarially sound and has over $3 billion in equity. Moreover, these changes are necessary to provide homeownership opportunities for first-time and low- to moderate-income homebuyers who would not be able to purchase

home without these changes.

The additional loans that FHA will be able to insure if the maximum mortgage limit is raised should be less risky and will offset the increased risk of low-downpayment loans. Again, the new loan limit will also provide the FHA with better regional balance, thus diversifying the FHA's portfolio and reducing risks. If the Subcommittee is particularly concerned about the risk of these loan programs, perhaps they should be administered by the Special Risk or General Insurance Fund.

Regarding the housing-counseling that will be required for participants in the 3% downpayment program, the NATIONAL ASSOCIATION OF REALTORS® believes that the organizations which HUD will certify to administer such programs should be particularly well-equipped to handle such pre-purchase counseling. Consequently, we believe that, to be certified by HUD, counseling organizations should be groups whose primary emphasis is homeownership, and who have sufficient experience in real estate practices to provide the most effective counseling possible.

Higher interest rates have also made it increasingly difficult for potential homebuyers to afford the monthly payment necessary to buy homes. Although HUD's current adjustable rate mortgage (ARM) program provides assistance to these homebuyers, the current structure, in which an ARM can adjust 1% per year and 5% over the life of the loan, is not as available or as convenient as other ARM products might be. As the Rouse-Maxwell Task Force report stated, "because FHA programs have not fully responded to innovations

in financing techniques, FHA buyers are denied access to types of mortgages that could produce more favorable interest rates."

Therefore, we support the provisions of the National Affordable Housing Act that authorize the HUD Secretary to insure other ARM products that are "generally accepted" in the mortgage market and to use up to 10% of the number of mortgages insured during the previous year to insure other types of mortgages that have achieved "general acceptance in the private market" on a demonstration basis.

While we have specifically supported an ARM that can adjust 2% per year and 5% over the life of the loan, we recognize that the flexibility which the bill gives HUD is an appropriate way to permit HUD to insure other ARM products. However, HUD should consider the likely effects on the GNMA market of any new security that might be issued prior to establishing any new ARM program. If the Secretary created too many ARM products, liquidity problems could affect the standard GNMA market as well. We want to be sure that no ARM programs are introduced without sufficient analysis of their marketability to investors, both to ascertain that the product is in fact "generally accepted" and also to assure that the GNMA program itself is not adversely affected in any way.

Similarly, we hope that HUD will examine carefully how acceptable any demonstration-type mortgage will be. FHA should continue to be a source of research and development for new mortgage products, so long as new mortgage products introduced by FHA meet a real need in the marketplace. HUD and FHA

have an important role in experimenting with new mortgage programs.

Mortgage Disclosure Requirements

The National Affordable Housing Act also includes a section revising current mortgage disclosure requirements. For a long time, the NATIONAL ASSOCIATION OF REALTORS® has supported the strengthening and enforcement of ARM disclosure requirements. Our current policy calls for continued work with lenders, Congress and the regulators to improve ARM disclosure requirements. Consequently, we support current disclosure requirements that require a hypothetical, worst case example, which we understand the bill will not change.

Participation by Retirement Plans in Equity Investment in Principal Residences

The legislation provides that an individual who owns either an individual retirement account (IRA) or a cash or deferred arrangement under Section 401(k) of the Internal Revenue Code may use those funds for investment in a principal residence without running afoul of current law rules that prohibit the use of either IRA or 401(k) plan funds to acquire, exchange, or lease property such as a principal residence. The proposed modifications in S.565 would permit a so-called "qualified home equity participation arrangement" to be free from these restrictions. Thus, the plan could hold all or a portion of the fee interest in a residence as an asset of the plan.

The NATIONAL ASSOCIATION OF REALTORS® supports this provision, but does suggest one modification. Proposed Code Section 4975(1)(2)(C) limits the purchase price amount. As currently drafted, a qualified home equity participation arrangement would be available only to the extent that the purchase price of the house or other unit does not exceed 110 percent of the average area purchase price as determined under the mortgage revenue bond provisions of Code Section 143(e)(2).

While we would favor a provision that has no such restriction, we recognize that this 110 percent limitation is consistent with the targeted area residence provisions of Section 143. We understand that this limitation is a safeguard intended to assure that the tax incentives provided are targeted to those for whom a tax incentive would be the major determinant of the acquisition of a home. We do believe, however, that it is important to give recognition to the peculiar problems of high housing cost areas. The income limits of Section 143(f)(5) make special provision for the qualification standards in these high cost areas. We believe a similar recognition of cost constraints should be reflected in this proposal.

Loans From Individual Retirement Accounts

Section 222 of the bill creates authority in the Internal Revenue Code that would permit an individual to borrow money from his/her individual retirement account (IRA) to be used solely for the purpose of making a first-time purchase of a principal residence. These loans would be repaid on disposition of the property. Generally, the safeguards and ownership criteria

of this provision are similar to those in the home equity participation provisions described above. We do, however, question the provision that requires that the loan be amortized over a 15 year period. We believe that it would be more appropriate for the taxpayer/homeowner to amortize the loan from the IRA over the same period as any mortgage secured by the residence, but not to exceed 30 years. In the case where there is no other mortgage secured by the property, we believe it is appropriate that the loan from the IRA be amortized over a term similar to that provided by conventional mortgage financing, but not to exceed 30 years.

Extension of Mortgage Revenue Bond/Mortgage Credit Certificate Programs

We support the extension of the mortgage revenue bond/mortgage credit certificate (MRB/MCC) programs through 1992. While we would prefer to see these provisions made permanent, we believe that a relatively long-term extension such as this is an important step. Under current law, recapture and family size limitations provisions apply to the MRB/MCC program. While the NATIONAL ASSOCIATION OF REALTORS® would support repeal of these restrictions, we nonetheless believe that extension of the program is the paramount objective.

Both of these programs are extremely important to the state housing authorities, particularly as the problem of homelessness grows, and as the prospects for homeownership are diminishing for America's young people. Each program serves important constituencies, and we believe that both should be extended for the same period. We believe that both of these programs have

been effective tools in making homeownership somewhat more attainable for a wide group of potential first-time homebuyers.

The MRB/MCC markets and constituencies are somewhat different, and so both programs are equally important to first-time homebuyers. Purchasers of new construction have typically benefited principally from the MRB program. MCCs are more readily available for the purchase of existing homes. Generally, MRB programs require large amounts of capital and also involve long lead times. The costs of issuing the bonds are substantial, and are typically recovered on the sale of new homes by the developer. MRBs generally have less utility in communities with low levels of new housing construction. Therefore, MCCs are often attractive in these already-developed areas.

Tax-exempt bond programs are fairly well understood by investors, and do not have a direct impact on home purchases, other than in the price of the home. By contrast, homebuyers and their agents are still learning to use the MCC program. Evidence collected to date shows that the MCC program has satisfied many of the objectives for which it was created. For example, data collected in California in 1988 show that 50 percent of the MCC holders have income between $20,000 - $30,000. For all groups except blacks, 75 to 80 percent of the MCC holders are less than 35 years of age. For blacks, 55 percent are under 35 years old. Nearly 14 percent of the MCC holders in this California survey were female heads of households. A North Carolina study showed that the average income of homebuyers receiving MCCs in 1987 was $25,400. Nearly 17 percent of all North Carolina MCC recipients had household income under $20,000, and 29 percent had income between $20,000 - $25,000.

Only 20 percent of MCC-assisted homebuyers had income between $30,000 - $34,500. Fifty-six percent of those individuals who qualified for MCCs were between the ages of 25 and 35, the principal household-forming years. The North Carolina survey also showed that 23 percent of MCC-assisted homebuyers said that they would have had to buy a smaller house without MCC assistance. Twenty-two percent said that they could not have purchased any house at all without MCC assistance.

The evidence collected to date shows that the MRB/MCC programs are working. We, therefore, urge you to extend them both.

Low Income Housing Tax Credit

Mr. Chairman, the National Affordable Housing Act contains a provision providing permanent authority for the Low Income Housing Tax Credit (LIHTC), leaving it to the Mitchell-Danforth bill to propose needed refinements. While the NATIONAL ASSOCIATION OF REALTORS® will comment on the Mitchell-Danforth bill in hearings on that legislation, we do want to express our strong support for extension of the Low Income Housing Tax Credit.

AFFORDABILITY IN THE RENTAL MARKET

The affordability problem is not, of course, confined to homeownership. As we mentioned earlier, the provision of adequate and affordable rental housing is an essential part of the housing arena, and an area which we feel the Federal Government's role is paramount.

The affordability problem in the rental market has been particularly intensified by adoption of the Tax Reform Act of 1986, which seriously cut back incentives to invest in rental housing. We believe that this withdrawal of incentives has caused and will continue to cause shortfalls in housing supply, causing rents to rise substantially. Multifamily starts have indeed fallen precipitously since the Tax Reform Act was passed: from 630,000 in 1986 to only 406,000 in 1988, a drop of 36 percent.

Affordability is particularly acute for low-income renters. According to the Census' American Housing Survey, a substantial majority of households with incomes below $10,000 and more than one-third of those with incomes between $10,000 and $15,000 pay more than 35 percent of their income for rent. For all renter households, gross rent as a percent of income has risen from a median of 24 percent in 1975 to 30 percent in 1987.

The 1985 Annual Housing Survey also indicates that 61% of very low-income renters pay more than 30% of their income on housing. 19% pay more than 30% of their income for housing and live in substandard or overcrowded housing. 41% of all very low-income renters pay more than 50% of their income for housing. This is more than 8 million people. More than 22 million people paid more than 30% of their income on rent.

These statistics underscore the need for additional housing assistance and the rapid development of affordable housing. The Congressional Budget Office (CBO) reports in "Current Housing Problems and Possible Federal Responses" that providing housing assistance to everyone who would qualify

under current income eligibility limits and household contributions would increase outlays over the CBO baseline by $11.1 billion when fully phased in. This demonstrates that the unmet housing needs of this country are extremely high, and that the government needs to do something to make housing more affordable and more available.

THE HOME CORPORATION/HOUSING OPPORTUNITY PROGRAM (HOP)

The National Affordable Housing Act attempts to resolve these large housing problems in a meaningful way. The bill addresses these problems by establishing new programs and institutions within HUD to promote the development of additional housing and modifies existing programs to make them work more effectively.

The National Affordable Housing Act would establish within HUD a new corporation responsible for providing Federal support to state and local strategies that expand the supply of affordable housing. The HOME Corporation will administer a Housing Opportunity Partnership (HOP) program to provide states and localities with resources to support housing programs. The HOP program will transfer resources to the State and local levels for use in programs that support efforts to provide affordable housing.

Mr. Chairman, the NATIONAL ASSOCIATION OF REALTORS® supports this concept. We believe that, given appropriate Federal assistance, States and localities can administer a variety of effective housing programs. Moreover, the Association considers such assistance to States and local governments as a

way to provide maximum assistance to needy families and persons with a minimum of bureaucratic overlay. The HOME Corporation and HOP program system, as written in the bill, meets these objectives by limiting the Federal bureaucracy and devising a direct and flexible stream of assistance to States and localities for use in providing affordable housing.

The NATIONAL ASSOCIATION OF REALTORS® supports this concept because we recognize that State and local governments have developed new and effective ways for dealing with the problems of providing affordable housing. During the last few years, the loss of federal funds for housing has forced state and local governments to address and take responsibility for their affordable housing needs. For most states, it has been a two phase process -- study and implementation. First, they have had to complete a comprehensive analysis in order to target specific needs and offer recommendations for programs. Furthermore, states and localities have had to determine their capacity to respond to those needs. Many states have established task forces or study groups which have researched the issue and provided recommendations for action. To date, some of the key findings have remained consistent -- (a) more affordable housing stock is needed and (b) the biggest hurdle to homeownership is the lump sum needed for the downpayment and closing costs. The second phase involves the design and implementation of programs to address the many faceted needs that are targeted. Subsequently, the states have focused on trying to find ways to encourage development of affordable housing and attempted to offer some assistance to their first-time homebuyers.

Once these communities have developed strategies for implementing housing programs, they need the wherewithal to administer them. Nearly all the cities and states that are taking an active role in addressing the affordable housing issue are using available Federal funding. Most programs are using Community Development Block Grant funds to assist their efforts to respond to their affordable housing needs. Given the initial funds, states and localities are able to leverage tremendous community resources and implement innovative programs -- they know their needs best. However, States and localities need more financial support. The Federal government can serve most effectively by offering flexible financial assistance for the design and implementation of unique local and state programs. Therefore, the HOME Corporation and HOP program assistance to State and local governments is an appropriate Federal response to the affordable housing problem.

In addition, the HOME Corporation would be a highly visible institution that could provide leadership for efforts to improve housing throughout the country. Such an institution would attract talented and committed staff to provide technical advice to housing providers around the country.

The bill authorizes $3 billion for the HOP program, to be provided in appropriations acts. We support this approach, emphasizing our position that funding should come from the general Treasury through annual appropriations, not from taxes assessed against real property owners. Furthermore, we recognize that the exact amount of money that will be provided for the HOP program will have to be determined at a later date, taking into account the variety of needs that this country faces in this era of tight budgets.

The HOP program itself would provide formula and incentive allocations to participating jurisdictions. Participating jurisdictions would have to match such allocations and would be able to use the funds for a variety of housing development purposes. Each jurisdiction would have to follow the bill's income targeting requirements.

The NATIONAL ASSOCIATION OF REALTORS® essentially supports all of these features of the bill. We agree that State and local organizations should be encouraged to continue to develop innovative approaches to providing affordable housing. In addition, we believe that matching requirements make sense, both to draw out the commitment of the participating jurisdictions and to extend Federal dollars as far as possible. We support the bill's language which addresses those situations where communities may face difficulty meeting the matching requirement.

State and Local Housing Strategies

To receive HOP assistance, States or localities must prepare a five-year housing strategy, which will describe the community's housing needs, analyze the obstacles to development, describe how the community plans to meet those needs and reduce those obstacles and report on several other community housing issues. Mr. Chairman, we believe that the requirement that applicants develop housing strategies will be an effective way for communities to assess their housing needs and determine what can be done to improve their housing conditions. We are especially interested in what local impediments contribute to the lack of affordable housing.

The bill requires States and localities to report on factors which are contributing to the diminished supply of affordable housing. While the factors listed under this requirement are important and relevent, we believe that there is an additional factor which plays a significant role in discouraging investment in rental housing in many markets: rent control and its adverse impacts. We suggest that the bill include rent control specifically as a local housing practice which should be discussed in the housing strategy, and that HUD be given the authority to withhold HOP funds from communities which refuse to reduce the negative impact of damaging rent control policies.

The NATIONAL ASSOCIATION OF REALTORS® firmly believes that the short supply of new multifamily housing development is attributable in part to restrictive government regulations. Solutions need to be developed to address the number of unnecessary government regulations that impede development and consequently increase development costs, such as stringent building codes, zoning regulations, impact fees, growth controls, and federally mandated wage rate standards. Private industry cannot be expected to provide an adequate amount of affordable multifamily housing unless governments at all levels alter their regulatory policies. Many of the regulations must be relaxed or even eliminated if you hope to stimulate housing production.

In fact, Mr. Chairman, we urge Congress to consider prohibiting Federal funds to those localities unwilling to revise unreasonable local regulations which inhibit the growth of affordable housing.

Other Support for State and Local Housing Strategies

The National Affordable Housing Act would direct the HOME Corporation to encourage the establishment of benevolent lending institutions to increase the flow of private capital into low-income housing. While the Association supports the concept of benevolent loan funds, we are concerned about the risk such funds may place on the FHA insurance fund and the U.S. Treasury.

We support the central idea behind benevolent lending, i.e., that funds can be made available to support low-income housing if some investors will be willing to accept less interest on fund deposits as a charitable act. However, Congress should ensure that any mortgages made from these funds will follow appropriate underwriting standards and processes to protect the fund. Because the FHA can be expected to insure many of these mortgages, Congress should require the FHA to develop procedures that will protect the insurance fund under this program.

S. 565 also directs the HOME Corporation to support locally initiated efforts to establish privately owned, local community development banks to finance affordable housing. Mr. Chairman, we support the concept of community development banks, because we recognize the effective ways in which such institutions can contribute to the production of affordable housing and revitalization of troubled communities.

Non-Profit Housing Organizations

Section 323 of the National Affordable Housing Act would require that each participating jurisdiction set aside 10% of its HOP funds for "investment only in housing to be developed, sponsored, or owned by nonprofit community organizations." The NATIONAL ASSOCIATION OF REALTORS® believes that the private sector may be best suited to recognize and respond to housing needs in most communities, and as such, nonprofits and profit-motivated housing providers ought to compete equally for funding.

RENTAL ASSISTANCE

The National Affordable Housing Act would establish a new form of low-income rental assistance, to be called "rental credits," which will replace the current vouchers and certificates. Incorporating the features of vouchers and certificates into a new hybrid could significantly improve rental assistance delivery.

The NATIONAL ASSOCIATION OF REALTORS® is interested in this new form of rental assistance; we would like to offer a few comments to inform you of our concerns.

First, the NATIONAL ASSOCIATION OF REALTORS® has concerns with the provision that restricts the amount of rental credits that States and localities can use as project-based housing assistance. The amount of rental credits that could be used for project-based assistance under the bill is not

sufficient to meet the existing demand for project-based subsidies. The Association has supported those programs that provide a project-based subsidy because project-based subsidies have the end result of encouraging the production of multifamily housing. If the government means to encourage the construction of new multifamily properties, and we believe it does, then the emphasis of this new housing program should be on project-based subsidies.

The Institute of Real Estate Management, an affiliate of the NATIONAL ASSOCIATION OF REALTORS® that specializes in multifamily housing issues, reports that under the voucher program, some project managers are reporting significant vacancies in some markets where tenants have taken their vouchers and "walked" to other projects leaving vacancies in some projects where vacancies never existed. This action is causing negative cash flow at these properties and consequent hardships and potential for defaults and foreclosures of some properties.

These properties were originally constructed as Federally-subsidized, low-income properties. When tenants are allowed to "walk" to other properties, the voucher program has caused a negative effect on the intent of the original housing programs. We recognize that tenant-based assistance can assist recipients in choosing housing themselves and that tenant-based assistance may be appropriate where there is an adequate existing stock of private rental housing. However, we believe that the bill should allow States and localities to use a higher percentage of their rental credit allocation for project-based assistance than the bill currently allows.

Project-based assistance promotes project and neighborhood stability by increasing the likelihood that tenants will remain in units where they are living. It encourages owners to provide housing for low-income persons for extended periods of time, thereby reducing the chances that tenants may be dislocated or displaced. In addition, assigning people who need housing to units covered by project-based subsidies eliminates some of the difficulty in finding housing associated with tenant-based assistance.

Moreover, housing markets in many areas are so tight that project-based subsidies are necessary to promote the development of affordable rental housing. The direct commitment of Federal resources through project-based subsidies is a more efficient way to encourage new construction and rehabilitation than tenant-based assistance. Finally, if owners are not assured that they will receive a guaranteed rent, then some of these structures will go into default, thus leading to higher claims on the insurance fund.

Secondly, we would like to comment on the bill's provision that rental credits carry a five-year commitment. We would recommend that you consider extending the commitment beyond a five-year period. If a longer commitment is provided then it will communicate to housing owners and developers that producing and maintaining affordable housing is not such a risky enterprise, and that they are assured of payments which will bring them an adequate return. Without this assurance, many owners may not feel confident enough to make the long-term commitment required to produce affordable rental housing.

Next, we would like to comment on the bill's provision to allow the Secretary to approve an alternative fair market rent (FMR) schedule with more than one fair market rent for an area if such an alternative schedule accurately reflects rent variations among submarkets within the area and will improve housing opportunities for targeted groups and provide low-income families with better access to employment and education. We believe that this provision makes sense and will enable HUD to more rationally set the FMRs to recognize submarkets where rent variations necessitate an alternative FMR schedule.

Finally, the bill proposes to limit eligibility for rental credits to people with family incomes at or below 50 percent of the area median, except for contract renewals and to avoid displacement of tenants from Federally subsidized apartments with incomes between 50 and 80 percent of area median. We have concerns with restricting income-eligibility to people with family incomes at or below 50 percent of median income because we believe it is socially advantageous to have mixed income dwellings.

Professional property managers believe that limiting assistance to the very poor ignores their practical experience which reveals that concentrations of families in the 50 percent of median income and below result in social and economic problems which increase management and operating costs and shorten the life of projects. While the concept is undoubtedly well-intentioned in its targeting of dollars to the very poor, it should be remembered that in 1974 the Department of Housing and Urban Development initiated a Community Development Act admonishing property owners, managers, and the FHA to avoid

"undue concentrations" of very low-income tenants. Subsequent to the 1974 legislation, income limitations were increased from 50 percent to the area median to 80 percent of the area median in order to avoid such an unbalanced concentration. If the targeting is maintained at 50 percent or below median, the Federal government could incur significantly more cost per family, especially in operating and management costs.

The National Affordable Housing Act would direct the Secretary to "establish procedures to assure that income data provided to public housing agencies and owners by families applying for or receiving assistance under this section is complete and accurate." The NATIONAL ASSOCIATION OF REALTORS® supports such income verification measures and believes that they can be effective in addressing fraud in the housing assistance system.

SUPPORTIVE HOUSING

The National Affordable Housing Act would modify the existing elderly housing program by providing funding through interest-free advances rather than the current loan system. We believe that this is a good idea that will reduce the budget authority required per unit. The NATIONAL ASSOCIATION OF REALTORS® also supports the bill's provisions that would develop programs to meet the supportive service needs of the elderly through "Project Retrofit" and other provisions. Furthermore, replacing the current fair market rent limitation on development costs with a standard based on local construction costs should improve the elderly housing development process. We also support the bill's efforts to improve the development of housing and provision of

supportive services for the handicapped and homeless.

PUBLIC HOUSING

The NATIONAL ASSOCIATION OF REALTORS® supports the bill's provision to reauthorize the Comprehensive Improvement Assistance Program. We believe that improving the housing conditions for public housing residents will contribute to a more decent and safer living environment. The existing stock of public housing units is a valuable housing resource which must be rehabilitated and preserved because affordable housing is so scarce.

We also believe that professional management would improve the conditions of many of the public housing projects around the country. Poor management has led to many of the housing problems we are experiencing today and which you are attempting to rectify in your bill. The NATIONAL ASSOCIATION OF REALTORS® believes that proper housing management is a key ingredient to the preservation of affordable housing while poor management contributes to the premature foreclosure of multifamily properties.

To further contribute to the ability of public housing residents to improve their living environment, the NATIONAL ASSOCIATION OF REALTORS® supports allowing tenants the opportunity to acquire ownership of public housing units. However, the Federal government should assure that the tenant can afford all the costs of ownership and that local resources be utilized to the maximum extent possible to assist those persons who want to work to move into homeownership and how to properly maintain the property.

In a related effort, S. 565 would create a new "Project Independence" to provide public housing residents with greater access to employment, day care, and other social services, such as education. Initiatives like this which will lead to greater opportunities for independent living and effective support services and job training may significantly improve the living conditions and future possibilities for many public housing residents and should therefore be tried.

Similarly, the National Commission on Severely Distressed Public Housing could provide a valuable service by identifying problems in troubled public housing projects and recommending what strategies can be used to improve the projects.

PRESERVATION OF AFFORDABLE HOUSING

S. 565 would create an Office of Affordable Housing Preservation within HUD. While the NATIONAL ASSOCIATION OF REALTORS® feels that this provision should not be considered until after Secretary Kemp has had an opportunity to review HUD's internal structure himself, we do recognize the difficult issues raised by the potential loss of hundreds of thousands of housing units due to prepayments, expiring contracts, or mortgage defaults. I understand that the Subcommittee plans to address this issue specifically in hearings later this month to develop legislative recommendations that would be included in the National Affordable Housing Act.

The NATIONAL ASSOCIATION OF REALTORS® has established a Study Group on Low Income Housing Preservation to investigate this issue and develop recommendation for how to address it. Our current policy states that the NATIONAL ASSOCIATION OF REALTORS® opposes attempts to change the terms of existing contracts by disallowing an owner's right to prepay their multifamily housing loan, but we are exploring options whereby the needs of the tenants can be met while maintaining the legitimate rights of the owners to dispose of the properties. Our Study Group is currently researching how HUD could provide incentives to owners to encourage them to maintain low-income housing affordability. We look forward to presenting the results of our Study Group's deliberations to the Committee and cooperating in whatever way is possible to develop solutions to this problem.

CONCLUSION

In summary, Mr. Chairman, allow me to congratulate you on the time and effort you have devoted to preparing the National Affordable Housing Act. It is a good bill, a good start at addressing the many housing problems which our country faces. I look forward to working with you and the Committee to improve this bill and ensure that it is passed and enacted into law. Thank you very much for the opportunity to testify before the Subcommittee.

news

NATIONAL ASSOCIATION OF REALTORS®
The Nation's Largest Trade Association

For Further Information Contact:

Liz Johnson 202/383-1043
Trisha Morris 202/383-7560
Lois Clinton 202/383-1016

NAR SUPPORTS HOUSING BILLS' EFFORTS TO HELP FIRST-TIME HOMEBUYERS

WASHINGTON (June 9, 1989)--Signs of a waning homeownership rate and the need for a national housing policy that focuses on the housing needs of first-time home buyers and renters, were critical topics discussed today by the National Association of Realtors.

NAR and other housing industry groups participated in a roundtable discussion before a U.S. Senate subcommittee on the pending National Affordable Housing Act, co-sponsored by Sens. Alan Cranston, D-Calif., and Alfonso D'Amato, R-N.Y.

NAR President Ira Gribin noted in written testimony submitted before the U.S. Senate Subcommittee on Housing and Urban Affairs, the alarming trend in the homeownership rate. "A decline in overall homeownership rates from 1980 to 1988 marks a reversal of the long-time trend of growth in this area and represents the first sustained one of its kind since the 1930s," Gribin said. He added that although the homeownership rate rose slightly in 1987, it subsequently declined in 1988, leaving it significantly below its peak at the beginning of the decade.

The affordability problem is not, of course, limited to homeownership, Gribin said. The provision of adequate and affordable rental housing is an essential part of the housing arena, and an area where we feel the federal government's role is paramount, he emphasized.

According to Gribin's testimony, the main factors affecting housing affordability include housing prices, income and mortgage interest rates. Gribin stated that first-time home buyers, typically adults in the 25-to-34-year-old category, face the most difficulty in realizing the goal of homeownership.

-more-

777 14th Street, N.W. Washington, D.C. 20005

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

"While the plight of first-time homebuyers has improved since 1982, first-time home buyers' incomes still are more than 20 percent below what is required to purchase a starter home," he said.

Aside from the home price, income and financing constraints faced by prospective home buyers, Gribin said there also is the question of a buyer's ability to make the required down payment. Those who already own a home and sell it to buy another have enjoyed home value appreciation and can use this gain as the down payment on another home, he said.

"First-time home buyers, however, are not so fortunate," Gribin said. "It is this segment of our population who face increasing barriers to realizing their goal of homeownership about whom we are most concerned. It is to this area that the association asks the subcommittee to give particular attention," he urged.

Gribin noted that prospective first-time home buyers tend to face both down payment and income constraints. They are, most often, younger households who have yet to accumulate substantial savings for a down payment and are at the lower end of their income earning curve.

"What all this data on first-time home buyers signifies is that this part of our population is being severely restricted by the market, and they are effectively under-housed because of their inability to purchase the typically priced home," Gribin said. Furthermore, he continued, the loss of first-time home buyers represents the most serious threat to housing markets. The homeownership rate of 25-34-year olds in 1988 was 45.0 percent of households, a decrease of 7.3 percentage points from the 1980 level of 52.3 percent.

Because the Federal Housing Administration is an extremely successful government program, Gribin recommended that the FHA program is a logical place to begin to address homeownership problems among first-time home buyers. First-time home buyers and low-to-moderate-income home buyers are precisely the population that the FHA program serves, he said.

Gribin said NAR is pleased to see that the act includes a provision to raise the current maximum mortgage limit by permitting the FHA to insure mortgages with values up to 95 percent of the median sales price of an entire state or for a substate area, where appropriate.

-more-

AFFORDABLE HOUSING ACT--add two

Raising the FHA insurance limit to 95 percent of the area median will help first-time home buyers greatly, Gribin said. It will make the program more flexible in terms of reflecting differences in housing costs among various areas, it will broaden the usage of the program, and the new limit will be responsive to changes in home prices over time, he said.

The National Association of Realtors supports the proposal to reduce down payment requirements under the FHA homeownership assistance programs to 3.0 percent of the first $50,000 of a mortgage and 5.0 percent of the remaining mortgage balance. The current down payment requirements are 3.0 percent of the first $25,000 and 5.0 percent of the amount exceeding $25,000.

NAR supports provisions contained in the act to authorize the U.S. Housing and Urban Development Secretary to insure adjustable-rate mortgage products that are "generally accepted" in the mortgage market for demonstration programs.

Other bill provisions endorsed by NAR include the following:

- Use of Individual Retirement Accounts, 401 (k) and other self-directed benefit plan funds for housing down payments;
- Continuation of the Mortgage Revenue Bond and Mortgage Credit Certificate Programs, which provide below-market interest rates and individual tax credits to low the after-tax cash cost of homeownership, respectively;
- Creation of a Housing Opportunity Program (HOP) to stimulate state and local initiatives to develop, renovate and maintain both rental and owned housing;
- Extension of the Low Income Housing Tax Credit;
- The concept of the HOME Corporation that would administer the HOP program to provide states and localities with resources to support housing programs.

The National Association of Realtors, the nation's largest trade association, represents nearly 800,000 members involved in all aspects of the real estate industry.

###

Karney Hodge
Director of the California Housing Finance Agency
President of the
National Council of State Housing Agencies

Presentation on the Homeownership Provisions of the National Affordable Housing Act

Before the Housing and Urban Affairs Subcommittee of the Senate Committee on Banking, Housing and Urban Affairs
June 9, 1989

Good Morning. My name is Karney Hodge, and I am Director of the California Housing Finance Agency, as well as President of the National Council of State Housing Agencies, a national association representing fifty-eight state housing finance agencies (all states except Kansas and Arizona; the District of Columbia, Puerto Rico and the Virgin Islands are also represented).

I welcome the opportunity to comment on the homeownership provisions of the National Affordable Housing Act. This is certainly the most far-reaching housing legislation we have seen in at least a decade, and we enthusiastically support its enactment. My comments today will illustrate the important role states have played in creating affordable homeownership opportunities, and the expanded role they could play in the future with the proposed federal support.

State Housing Finance Agencies (HFAs) have assisted nearly one million households purchase their first home. Relying primarily on the issuance of Mortgage Revenue Bonds and Mortgage Credit Certificates (MRBs and MCCs), State HFAs have used the capital markets and a network of participating private lenders to create low cost mortgages. This capacity is especially important today with the difficulties prospective homebuyers face and the crisis facing the nation's mortgage finance system.

After four decades of continuing expansion, the rate of homeownership began a decline in the 1980s. Whereas the national homeownership rate stood at 65.6 percent in 1980, the 1988 rate stood at 63.9 percent. For young households, the declines were greater, falling from 43.3 percent to 36.2 percent for 25-29 year-olds, and from 61.1 percent to 52.6 percent for 30-34 year-olds.

This decline comes at a time when, according to The State of the Nation's Housing 1989, of the Joint Center for Housing Studies at Harvard University, the after-tax cash cost burden of homeownership was 32.8 percent of income in 1988. This is "some 50 percent higher than the share of income required to pay for the typical starter home in the early 1970s." Moreover, the Joint Center also finds that "in 1988, the downpayment burden was 54.5 percent of the first-time buyer's income, up 25 percent from the early 1970s".

The implications of declining homeownership for the nation are profound as a recent Federal Reserve Board study indicates. As cited by The State of the Nation's Housing 1989, the "equity build-up associated with homeownership appears to magnify difference in income into larger disparities in wealth . . . homeownership enhances the economic well-being of households. For decades, improved housing conditions have been an important element in the upward mobility of American families and individuals. Prohibitively high housing costs can only add to the growing inequality in income and wealth in America in the years ahead."

State HFAs have been in the forefront of efforts to arrest deterioration in homeownership opportunities. In a study published last spring by Dr. Margaret Wrightson, of Georgetown University's Public Policy Program, an analysis of over 210,000 loans in State HFA portfolios between 1983 and 1987 indicates that borrowers under these programs have significantly lower incomes and purchase more modest homes than those under Federal programs such as FHA and VA. The study concludes that through special targeting practices and innovative delivery mechanisms, states have been able to reach those borrowers at the *very lowest* qualifying ranges, those who otherwise would have been "borderline" or not qualified at all in the conventional market. MRB and MCC programs are filling a niche in the market which would otherwise go unserved.

California's Efforts to Expand Homeownership Opportunities

In California, our homeownership program has been challenged, during a time of volatile interest rates, to provide loans at below market interest rates to the broadest base of borrowers possible. Several programs have enhanced our capacity to do just that, including: 1) Self-Help Housing Program; 2) Matching Down Payment Program; 3) Nonprofit Housing Program; and, 4) California Housing Insurance Fund.

Our Homeownership programs have been restructured to allow for both new construction, as well as resale of existing homes, with fund commitments at variable terms and corresponding fees. This has provided wider opportunities for participating lenders and developers to enter commitment agreements tailored to their specific needs, broadening the selection of lenders and developments available, and therefore, the number of borrowers.

Through our *Self-Help Housing Program* families with limited downpayment resources can obtain homeownership through "sweat equity" (a personal contribution of labor), rather than a monetary contribution. Nonprofit developers select eligible families, acquire land, provide building plans and supervise construction. Families typically devote between thirty and forty hours per week for seven to nine months. The interest rate on loans has been 7.5 percent. The California HFA also has provided a reduced commitment fee structure to assist in lowering costs to borrowers.

California's *Matching Down Payment Program* also addresses the critical lack of resources among first-time homebuyers by providing a deferred loan of up to $5,000 on a matching basis to borrowers in rural and target areas whose incomes do not exceed 80 percent of median, adjusted for family size. The deferred payment second loan carries 3 percent simple interest (principal and interest is deferred for up to 30 years or until the home is sold or refinanced).

California's *Nonprofit Housing Program* exemplifies the role played by many State HFAs in encouraging low cost development and rehabilitation of homes by local and national nonprofit agencies. In California, a source of permanent financing is provided for single family homes developed by nonprofits which serve lower income families. The interest rates during the past year have been as low as 7.25 percent. The California HFA also provided a reduced commitment fee structure to assist in lowering costs.

In the area of credit enhancement for homeownership programs, the California HFA has responded positively to the recently developing problems in the private mortgage insurance industry. Most new loans being made are FHA-insured. Loans not eligible for FHA insurance are now being insured by the *California Housing Insurance Fund*, which was created by the California HFA, although it operates independently, in the same manner as a private mortgage insurance company.

Leadership by State Housing Finance Agencies

As in California, states across the nation have developed innovative approaches to meeting the needs of first-time homebuyers.

A few examples of programs representing these special targeting and delivery mechanisms are described below. The programs are selected for illustrative purposes, and do not begin to represent a compendium of all the innovative HFA programs currently in operation. These programs exemplify a variety of approaches taken by State HFAs to reach first-time homebuyers, including: 1) Combining MRBs with Other State and Federal Resources (FmHA, HUD, et al); 2) Interest Rate Buydowns; 3) Downpayment and Closing Cost Assistance; 4) State or Agency "Self" Insurance Programs; Private Mortgage Insurance Risk-Sharing; 5) Geographic Distribution of Capital; Rural Programs; 6) Development Funds for Nonprofits; 7) Affordable Housing Design; Land Banks; 8) Energy and Home Improvement Programs. Again, these model program descriptions are illustrative, rather than exhaustive listings, and demonstrate the breadth of activities State HFAs have undertaken in the homeownership area.

MRB Coordination With Other Federal Programs

The importance of the FHA and VA insurance programs to state HFAs, and more directly, to first-time homebuyers, cannot be overstated. For over twenty-three states, FHA insurance represents the primary credit enhancement for the bulk of their loan portfolio (from 50 - 100 percent of all their loans in calendar year 1987 were FHA-insured). As stated earlier, HFA borrowers fall well below the average income and purchase price levels of all other FHA/VA borrowers, thereby confirming the deeper targeting which can be obtained through a coordination of the two programs.

In addition to FHA and VA insurance, HFAs have looked to other resources that these Federal programs can provide. In the past few years, for instance, REO properties have been used creatively to reach lower-income borrowers in several states. In addition to the resources of HUD and the Veterans programs, the Farmers Home Administration (FmHA) has also proven instrumental to HFAs.

√ Texas Housing Agency's *HUD REO Program* made a set-aside of MRB funds available to lower-income borrowers to enable them to purchase certain HUD foreclosed properties. With relatively low sales prices, the agency was able to serve borrowers with much lower incomes than their regular program.

√ West Virginia Housing Development Fund's *FmHA REO Program* utilizes FmHA foreclosed properties which are renovated where necessary by the HDF and made available for sale to large families through the FmHA 502 program, with interest rates as low as 1 percent. The WVHDF guarantees the loan for the first three years (the most likely time for buyers to default).

√ New Hampshire HFA/*FmHA Homeownership Program* combines the funds of the HFA with FmHA to be loaned at various rates and terms depending on borrowers' incomes. FmHA provides interest credit assistance in order to reduce the effective interest rate on the FmHA portion as low as 1 percent. By combining this with HFA funds, certain low-income borrowers may qualify for loans as low as 3 1/2 - 4 percent on the total mortgage amount.

Interest Rate Buydowns

A key factor in determining the affordability of homeownership for first-time homebuyers is the available interest rate. State HFAs have been able to target their programs to borrowers with the lowest incomes possible because they offer interest rates approximately two percent below market rates. However, when HFAs "buy" the interest rate down even further, to an effective rate of 4 percent, for instance, they are able to serve families with incomes as low as 50 percent of median.

√ The State of New York Mortgage Agency's *Modest Means Homebuyers Demonstration Program* made $10 million dollars in mortgage money available to lower income borrowers at 4 percent interest in 1987. The state legislature is considering funding to make the program permanent.

√ Maryland Community Development Administration's *Home Financing Program* is offered when funds are available and provides set-asides for nonprofit developers so low-income buyers have a source of mortgage money. Interest rates vary from 4-6 percent. Minimal cash down is required; closing costs may be borrowed in some cases.

√ Massachusetts HFA's *Homeownership Opportunity Program* is available to borrowers with incomes no higher than 80 percent of median. Interest rates are offered at 3 percent below other MHFA loans and coupled with reduced purchase prices, in order to qualify those who otherwise could not become homeowners. The 3 percent interest rate subsidy declines, so that at year twenty, the borrower pays the full MHFA rate. Long-term affordability is ensured through deed restrictions and recapture of a portion of the interest subsidy.

Downpayment Assistance

Downpayment and closing costs represent one of the most significant barriers to homeownership for first time buyers. Nearly twenty states have special programs to provide assistance in this area, including:

√ Minnesota HFA's *Home Ownership Assistance Fund* (HAF) provides monthly and/or downpayment assistance to income eligible borrowers; provides for borrowers who would not qualify on an income underwriting basis for Minnesota's Mortgage Program without this additional help. HAF takes the form of a zero-interest second mortgage loan that is later repaid according to a preset schedule.

√ New Hampshire HFA's *Downpayment Loan Program* provides loans of up to $10,000 to assist low and moderate income homebuyers in making downpayments. This is a state funded revolving loan program with an initial allocation of $1 million. Loan recipients must have incomes no greater than 100 percent of median.

√ West Virginia Housing Development Fund's *Closing Cost Subsidy Program* provides direct subsidies to households for payments of loan closing costs in the Single Family Mortgage Program. Participants must meet certain income limits.

Self-Insurance; Risk Sharing

In response to unprecedented losses in several parts of the United States in the early 1980s, the mortgage insurance industry began to tighten its underwriting guidelines, essentially limiting the number of first-time homebuyers who could be served. Many lowered their underwriting ratios, eliminated gifts as part of the downpayment and required cash reserves by the borrower for the equivalent of two months' principal, interest, taxes and insurance. Many no longer wrote pool policies for HFAs. In order to ensure that adequate mortgage insurance was available to borrowers, most HFAs undertook new initiatives, on their own or in cooperation with private mortgage insurers.

√ Massachusetts HFA's *Agency Self-Insurance Fund* offers an alternative to borrowers under Massachusetts' Homeownership Opportunity Program. Utilization of the fund results in savings to the borrower on the initial mortgage insurance premium and alleviates the requirement of two months' worth of principal, interest, taxes and insurance (PITI) in reserve. Five percent downpayments and gift letters for up to one-half the downpayment from relatives are acceptable.

√ Vermont's *Home Mortgage Guaranty Board* provides low cost mortgage insurance for borrowers under the Vermont HFA's homeownership programs. The Board is self-sustaining through mortgage insurance premiums and has been in operation since 1974. Again, this state insurance offers greater underwriting flexibility and much lower premiums than conventional mortgage insurance.

√ New Hampshire HFA-*GEMICO Risk Sharing Program* shares the same goals as the aforementioned agency or state "self-insurance" programs: a reduction in premiums and greater flexibility in underwriting. Under this arrangement, the New Hampshire HFA shares the insurance risk with GEMICO, thereby reducing premiums by about 50 percent; underwriting debt ratios have been increased; 5 percent downpayments on condominiums will be accepted; loans with HFA downpayment assistance may go as low as 3 percent down.

√ Alaska Housing Finance Corporation's *Home Ownership Assistance Program* (HOAP) worked with existing pool and primary insurers to modify loans that had been made during stronger economic times. Taxable bonds were issued in order to replace adjustable rate mortgages with lower-interest fixed rate mortgages for those borrowers who were currently delinquent or in jeopardy of foreclosure. The Alaska program represents the most ambitious HFA workout completed in cooperation with mortgage insurers to date and may represent a model for other states with high delinquency rates.

Geographic Distribution of Capital

State HFAs have been able to meet an urgent need in many states by providing mortgage capital in rural and inner city areas, where lenders may be reluctant to do so. In some cases, in fact, the HFA represents the primary source of capital, either in particular regions, or throughout the state. Particularly in states which have suffered economic downturns, the HFA plays an increasingly important role in the provision of mortgage funds.

√ West Virginia Housing Development Fund's *FNMA Direct Seller-Servicer* status will allow them to originate and service loans anywhere in the state and directly sell them to FNMA. This initiative stems from the dearth of qualified originators and servicers in many areas of the state and the WVHDF's desire to maintain such functions within the state, rather than turning to out-of-state firms to maintain the economic benefits of such activity within the state.

√ Virginia Housing Development Authority's *Rural Homesteading* represents a partnership between VHDA, FmHA, and HUD that turns vacant, substandard houses into decent, livable homes for low-income rural families. It was the first rural homesteading program in the nation. The houses are sold to qualifying families for as low as one dollar. FmHA provides rehabilitation financing with a term of 33 years and interest rates as low as 1 percent. If

borrowers meet program requirements for five years, the property is deeded to them.

√ Tennessee Housing Development Agency's *Rural-Inner City Program* provided a special set-aside of funds for 45 rural counties and census tracts and 11 metropolitan communities which needed special attention. Borrower income limits were lowered and the origination fee was waived.

Development Funds for Nonprofit Organizations

In response to changes in the tax code and decreasing federal subsidies, State HFAs have had to play increasingly entrepreneurial roles in packaging a variety of funding sources to make any one housing project "pencil out." Historically, HFAs have worked closely with nonprofits, however, the level of coordination has increased dramatically in the past few years.

√ New Jersey Housing and Mortgage Finance Agency's *Housing Assistance Corporation* is a subsidiary corporation which may contract indebtedness. HASCO's major focus is to draw together a variety of existing funding sources and make them available for the development of housing. The agency provides technical, financial, development and physical management assistance to municipalities through cooperation with nonprofits and private developers.

√ Georgia Residential Finance Authority's *Georgia Appalachian Housing Fund* and *Development Advances for Nonprofits* are two funds which are limited to nonprofit organizations engaged in the development of low and moderate income housing. The Georgia RFA provides extensive technical assistance to such nonprofits, including regularly scheduled training workshops.

√ North Carolina HFA's *Special Project Fund* utilizes prepayments to provide low-interest financing to partnerships involving local governments or nonprofits working with private lenders and builders. Borrowers must have incomes of less than 80 percent of median.

√ State of New York Mortgage Agency's *Nehemiah Project*, in cooperation with the City of New York, the Archdiocese of Brooklyn and a coalition of church and community groups, put together $29 million to build approximately one-thousand single family (three bedroom) rowhouses in East Brooklyn for buyers at about 50 percent of median. Although no HUD funds were used to create this program, it serves as the model for the HUD-funded Nehemiah Demonstration.

Affordable Construction/Land-Use

State HFAs have been leaders in the effort to create more affordable design technologies, as well as workable land-use policies at the state and local level. To encourage innovation among developers and local governments, a variety of incentive programs have been created.

√ Minnesota HFA's *Innovative Loan Program* is used to encourage innovation in the development or rehabilitation of both single and multifamily housing. Both nonprofits and for-profits may apply for financing for projects involving innovations in construction method, materials, equipment, design and marketing. Loans to nonprofits are interest free, while for-profits pay a low interest rate.

√ Maine State Housing Authority's *New Housing Initiatives Program* and *Community Affordable Housing Program* offer two models for affordable housing development. In the New Initiatives Program, innovative housing proposals are financed which do not "fit" the normal categories of housing construction and rehabilitation. For instance, in Lincoln County, funds were used to purchase land and new mobile homes for a four-unit subdivision where very low-income tenants will have a lease-purchase option. The Community Program fosters interest among local communities in affordable housing, by combining local resources with private resources, to create affordable housing in many communities where young native families are unable to buy homes. Communities must make a positive contribution to reducing housing costs, for instance through donating municipal land or buildings and by amending land-use requirements to permit innovative development methods that reduce per unit housing costs.

√ New Hampshire HFA's *Mobile Home Park Limited Equity* program provides financing in the form of fixed or second mortgages to mobile home park tenant cooperatives to assist them in the purchase of their parks from current owners. The Agency sees the program as an innovative way to use discretionary funds to preserve a source of low and moderate income housing, while still realizing a reasonable return on investment.

√ Rhode Island Housing & Mortgage Finance Corporation's *Land Bank Program* makes low-interest loans available for the purchase of undeveloped land for eventual use in constructing affordable housing to meet specified targeting requirements. Approved proposals receive 100 percent financing for new purchase or refinancing of already-owned land. Only nonprofit sponsors and government authorities are eligible borrowers. The program

provides the nonprofit community with an available source of capital to produce affordable housing.

Energy and Home Improvement Programs

State HFA programs directed at energy and home improvement financing represent an effort to fill an important market niche. It has traditionally been very difficult for low and moderate income families to obtain financing for such activities, particularly to bring their homes into code compliance. Additionally, it is often difficult to obtain funds for rehabilitation in conjunction with the initial purchase, at favorable interest rates. HFAs have developed a number of programs to address these needs.

√ Connecticut HFA's *Combined Purchase Rehabilitation Loans* allow buyers to purchase and rehabilitate a home with one loan. The program is also used by owners seeking to combine a refinancing of an existing home with additional funds for rehabilitation. Nearly one thousand loans have been made.

√ Minnesota HFA has several programs to assist new or existing homeowners in making energy or other improvements to their home, at very low rates (as low as 3 percent depending on income). Set-asides are available for communities who wish to address urgent local needs (for example, code compliance).

√ Georgia RFA's *Energy Fund*, as were several other state energy programs, was initially funded with "oil overcharge" dollars, though is now a revolving loan fund. Financial assistance takes the form of either a low-interest loan or a combination of loan and grant, depending on household income.

Other Special Targeting

√ Massachusetts HFA's *High Priority Loan Program* ensures the availability of funds for high priority borrowers (lower income, Vietnam-era veteran, minority, physically disabled) through a set-aside of 50 percent of all bond proceeds for the first 160 days such funds are available.

√ Minnesota HFA's *Indian Housing Programs* are designed to address special housing needs of low- and moderate-income American Indian families living on or near state Indian reservations, or in urban areas of the state. Recipients must meet special requirements. This is the only state-sponsored Indian housing program and is flexible in order to meet locally identified housing needs (homeownership, rental, and rehabilitation).

√ Missouri Housing Development Commission's *Blended Single Family Program* was created to foster additional redevelopment in inner-city areas and in older neighborhoods of smaller communities. Loans are normally 3 -4 percent below market rate and assist in the construction or rehabilitation of single family homes.

√ Rhode Island Housing and Mortgage Finance Corporation's *Access Independence* makes available low-interest deferred-payment loans (with a loan cap of $10,000) to finance home improvements to make a home more accessible to handicapped persons.

Observations on S. 566/568 - Title II - Homeownership

This title takes three approaches to improving homeownership opportunities for first-time homebuyers and long-term renters. The Federal Housing Administration (FHA) mortgage insurance program would be amended to increase allowable purchase prices in high cost areas, to lower downpayment requirements and to facilitate the use of adjustable rate mortgages. Housing would become an eligible 401(k) investment to make these savings available to qualifying homebuyers for home downpayments. The Mortgage Revenue Bonds and Mortgage Credit Certificate (MRBs and MCCs) programs would be extended for three years.

NCSHA recommends that all descriptions of single family properties in the bill include "new 2-4 unit" properties (which are now omitted) in order to expand the available housing stock for ownership.

NCSHA also recommends that the definition of first-time homebuyers add as eligible borrowers: "individuals purchasing their first homes following divorce." Current law excludes, indirectly, divorced men and women if they shared title with their ex-spouses on their prior properties. This exclusion specifically impacts single mothers with children, who represent a large percentage of the low-income population most in need of the benefits of homeownership.

Mortgage Revenue Bonds/Mortgage Credit Certificates

MRBs and MCCs would be extended for 3 years.

Comments: MRBs and MCCs have demonstrated an impressive ability to assist lower income homebuyers through FHA, VA and the conventional market.

When combined with FHA insurance or VA guaranty, MRBs and MCCs improve the ability of these programs to assist lower income homebuyers.

We recommend certain improvements to strengthen the MRB and MCC programs including: removing the prohibition on use of MRBs and MCCs to finance a home in newly constructed 2-4 unit buildings, and allowing MRB proceeds to make loans to nonprofit owners agreeing to sell the home to an eligible renter under a lease-sale arrangement.

FHA Amendments

Loan Limits: Maximum loan limits would be set at 95 percent of the median sales price for the state or for a multi-state metropolitan area.

Comments: NCSHA believes that a priority of this legislation should be the achievement of consistent targeting among programs, especially where the programs are used in combination. The MRB and MCC purchase price limits of 90 percent of the higher of state or area median income should be considered as an alternative to achieve consistency between these two programs.

Downpayments: Requirements would be lowered through FHA coverage of up to 97 percent of the first $50,000 (from $25,000) of the value of a home and 95 percent of the value in excess of $50,000.

Comments: The 97% should be based upon the lower of purchase price or appraised value to preclude the chance of appraisal fraud. Use of a percentage of purchase price, rather than a specific dollar amount also conforms to the current MRB provisions.

For homes selling for more than $50,000, the downpayment savings would be $750.

While these two provisions on loan limits and downpayments are improvements over current FHA caps (which have rendered the program useless in many high cost areas), they may fall short of what is needed to make FHA workable in some areas. Current private sector trends (for instance, GEMICO co-insurance agreements with certain HFAs) allow as high as 97-1/2 percent of full value for first-time homebuyers.

Homebuyer counseling should be mandated for clear understanding of the implications of the low downpayment.

Adjustable Rate Mortgages (ARMs): Interest rates on FHA insured ARMs would be permitted to rise two percent per year and not exceed five percent during the life of the loan.

Comments: The Federal Savings and Loan Insurance Corporation (FLSIC) crisis raises caution. The combination of MRBs and FHA insurance already has demonstrated an ability to assist lower income households. Moreover, Fannie Mae already provides a secondary market for over thirty different types of ARMs, limiting the need for FHA involvement.

The benefit of ARMs to low-income borrowers does not compare favorably with fixed rate mortgages issued with tax-exempt financing because the start rates are not reduced enough to significantly enhance affordability unless deep discounts are offered, which places borrowers at undue default risk when their payments increase. Further, default risk for FHA is significantly increased. This experience is widely documented in the conventional marketplace.

Specific to the legislation, it is unclear as to who would define the ARM as "generally accepted in mortgage market." Teaser ARM rates should be avoided. Qualifying a homebuyer who cannot afford to retain the home can place a young family in a cruel dilemma. The legislation should also provide for "rate-lock disclosure."

Mortgagee disclosure does not correlate with true comprehension, however. Borrowers often sign disclosure documents and may even believe they understand the terms of an ARM, but may not comprehend the full impact of the downside risk until it occurs. Again, this situation is widely documented in the conventional market.

FHA-insured ARMS are already available through the MCC program, and fuller utilization of this financing arrangement serves two purposes: 1) sharing risk of ARM financing with private investors, and 2) making the widest variety and most affordable, least risky products offered in the conventional market available to low-income borrowers. Extension of the MCC program will effectively achieve the advantages of ARMs without increasing the risk to FHA (in those states where MCC programs are operational).

General Comments on FHA: In recent years, FHA has made significant improvements in its ability to assist the first-time

homebuyer market. These improvements have been especially helpful to State HFAs using FHA insurance.

- FHA is helping potential first-time homebuyers:
  - by allowing the downpayment to be a gift (unlike many conventional lenders who require a minimum 5 percent downpayment from the cash reserves of the borrower)
  - by allowing both the mortgage insurance premium and the closing costs to be substantially financed.

- Processing time savings have been gained through use of:
  - compliance inspections or 10 year builder warranty programs in lieu of Minimum Property Standards,
  - direct endorsement lending in lieu of agency appraisals and underwriting,
  - release of handbook 4155 to provide a one-stop guide to lenders,
  - adoption of the Uniform Residential Appraisal Report and other uniform documentation to facilitate reprocessing of loans switching from FHA to VA, and
  - use of the "credit alert" phone system to allow lenders to identify applicants who have previously defaulted on government loans.

- FHA has freed its interest rate to float with the market and thus eliminated the possibility that "discount points" would kill a transaction.

Regulatory changes currently being considered by FHA would implement a switch to conventional debt ratios to conform with other secondary market participants. Preliminary assessments by HFAs indicate that the change from net to gross debt ratios for FHA underwriting would improve the capacity of state agencies to use the program.

Savings for a Downpayment

Individuals may withdraw up to $10,000 from their 401(k) account to invest in a home purchase.

Comments: The $10,000 limit is confusing and artificially restrictive, particularly in high cost areas. While NCSHA supports this proposal, it is important to note the impact which the time value of money will have. In markets where home prices escalate faster than the interest rates on standard savings instruments, the value of savings for a deferred purchase is diminished, and in fact, may not be useful at all.

An option would be to amend the tax code for single family to allow the proceeds of tax-exempt financing to be applied to a non-eligible owner for the purpose of a lease-purchase agreement with an eligible owner/renter. Thus, price is locked in, allowing the borrower to occupy the home sooner and with a quantifiable savings goal which will not be inadequate to purchase the home.

Observations on S. 565/566 - Title III- The Impact of HOME and HOP on Homeownership

A key component of the legislation, the HOME Corporation and Housing Opportunities Partnerships (HOP) would provide both an institutional and funding mechanism for participating states and local governments. The HOP funds administered by the HOME Corporation would be available for use for homeownership programs. Aspects of the proposal would limit the applicability for this purpose.

Income Targeting

Each jurisdiction must invest at least 40 percent of its funds in units occupied by very low-income households (50 percent of area median income or less).

No less than 80 percent of a jurisdiction's funds must be invested in units serving low-income households (80 percent of area median income or less).

All funds must be invested in "affordable housing."

Comments: The requirement that 80 percent of HOP funds be invested in units serving households of 80 percent of area median income or less will make it difficult to use HOP funds to support homeownership programs. As a comparison, the Mortgage Revenue Bond (MRB) program allows loans to households whose incomes do not exceed 115 percent of the state or area median if the household has three or more members and 100 percent of median for one or two person households.

The 80 percent provision will make it difficult to use HOP funds in combination with MRBs. For example, a state might wish to use HOP funds to support a downpayment program to augment its MRB program. This restriction will be particularly limiting for states with little multifamily housing and for states such as Texas and Oklahoma, which have a glut of devalued single-family homes.

HFAs are committed to the provision of low and moderate income housing and support directing limited resources toward that goal. New resources and existing programs must be integrated and coordinated for maximum impact, however.

NCSHA urges consistency in income targeting between HOP funds and the tax based programs: Mortgage Revenue Bonds and Mortgage Credit Certificates.

Homeownership/Program Targeting

Home purchase prices cannot exceed 95 percent of the area median purchase price as determined by the Secretary, with adjustments for different structures and new and old housing as appropriate. Homes must be the principal residence of the owner. Homes must be available for initial purchase only to families who have not owned a home in the previous three years.

Households must qualify as moderate-income (income does not exceed the area median family income as determined by the HUD Secretary with adjustments for family size and high costs) at the time of purchase.

Homeownership opportunities must be provided to families with a broad range of incomes, including a preponderance of low-income families.

Comment: Again, it is important that the homeownership program targeting is consistent with MRB targeting. The MRB program, which is tightly targeted, requires that household income not exceed 115 percent of state or area median income (whichever is greater) if the household has three or more members and 100 of the state or area median for one or two person households.

In addition, for homeownership, the average area purchase price as prescribed in U.S. Code Section 143(e)(2) for Mortgage Revenue Bonds should be used in lieu of the area median purchase price to ensure consistency among programs and facilitate combination where needed.

Matching Requirements

Each participating jurisdiction must make a matching contribution equivalent to at least 25 percent of funds received throughout a fiscal year. Cash contributions, administrative expenditures (up to 7 percent), the value of waived fees, the value of contributed land and other Secretary-approved in-kind services shall qualify as matching contributions.

Comments: States have and will continue to commit resources to the provision of affordable housing. The 25 percent match should be eased, however, for states suffering structural economic decline which significantly alters housing needs or the distribution of income and population.

In accounting for the match, the key concern should be that the aggregate match equal the required. The requirement that the line of credit be matched "throughout" the year, while preventing unnecessary deferrals, could present problems. Conflicts may arise with the timing of state appropriations. Moreover, the percent of matching funds applied to one project may differ from that of another.

NCSHA strongly supports the five year housing strategy submission. Particularly in areas where housing markets are interdependent and lending policies are based on multi-state bank holding companies, a coordination and standardization of policy is essential to the successful implementation of programs.

Conclusion

State homeownership innovations offer a blueprint for this landmark legislation. By building upon the success of the MRB program and strengthening the FHA single family insurance program, the existing foundation for expanding homeownership opportunities is improved. Upon this foundation, the legislation adds an array of new tools and resources. The HOME Corporation's ability to identify and disseminate model programs, of which State HFA examples abound, and the use of HOP funds to implement these models are groundbreaking measures.

We commend you for this exemplary effort and pledge our support toward its enactment.

Statement of
Robert H. Edelstein

Professor, Business Administration
Chair, Real Estate Faculty Group,
Co-Chairman, Center for Real Estate and Urban Economics
Walter A. Haas School of Business
University of California at Berkeley

Before the Subcommittee on Housing and Urban Affairs
Committee on Banking, Housing and Urban Affairs
United States Senate

Round Table Hearing on "Homeownership and Affordable Housing"
with Emphasis on Proposed Legislation S.565 and S.566, the
National Housing Act

June 9, 1989

Mr. Chairman and Members of the Sub-Committee:

Thank you for the opportunity to appear before your sub-committee to participate in the Round Table discussion of S. 565 and S.566. I applaud the introduction of the prospective legislation which represents a potentially important vehicle for commencing the long overdue re-examination and re-direction of our nation's housing policy.

My comments are divided into four parts. First, I will provide a schematic, stylized overview of national housing policy goals. Second, I will explore the underlying demographic forces that have been and will continue to be the key determinants of housing demand. Third, I will address the specific proposal of the National Affordable Housing Act which would create regional differential limits for FHA insured loans. Finally, I will delineate major issues that are likely to confront and confound the future path of housing policy.

I. National Housing Public Policy Goals: An Overview

Housing policy uses scarce public resources. The efficient use of these resources is clearly important. To some extent, housing policy may need to recognize trade-offs between equity (fairness) and efficiency. Fairness goals must not be set aside: how a nation shelters the less advantaged households is a demonstration of its commitment to economic justice. The resources devoted to national housing policies should necessarily be directed at those who are disadvantaged (i.e., low- and middle-income households as well as the indigent homeless).

The Housing Act of 1949 sets a national goal of "a decent home in a suitable living environment" for all Americans. Subsequently, homeownership has been encouraged by a combination of mortgage and tax policies, and the supply of low- and middle-income housing has been promoted by an array of direct and indirect housing programs. This dual focus, until the past several years, reflected the national consensus about the role of housing in our society.

Homeownership has been an important public priority since the end of the Second World War, when the Federal Government established programs to encourage home purchases by Veterans. Federal mortgage and subsidy programs, tax incentives, and low interest long-term mortgage loans have enabled approximately 65 per cent of all American households to own homes.

However, during the last two decades, the ability of housing policy to create sufficient affordable housing for the new generation of Americans entering the housing ownership market has been seriously questioned. Can housing policy prevent periodic housing shortages with their attendant price spirals, and allow continued mobility of our society, which is crucial to meet changing employment patterns? These are the concerns that S.565 and S.566 appear to address and re-evaluate, while continuing to endorse earlier housing goals and social priorities as established by the Housing Act of 1949.

II. The Root Causes of the Housing Ownership-Affordability Crisis: A Closer Look At Changing Demographics

In order to understand the sources of housing demand one needs to examine the underlying demographic patterns. The size and age distribution along with the growth rate of population are the most crucial factors influencing the nature and extent of housing demand. The demographic surge of the 1980s was engendered by the maturation of the World War II baby boomers, and has led to unprecedented demand for housing units in the 1980 decade. At the national level, the implications of this huge demand are that resources used for housing are forced to compete against alternative goals of public policy. Governments at the state and local level must also be involved since housing demand affects not only land use, but infrastructure, as well as increased need for basic levels of government services.

As can be seen in Table 1, the total number of births of the post War baby boom (and the birth rate) peaked in the early 1960s. The birth rate has declined substantially since that point reaching its nadir in the early eighties; while the number of births has declined reaching its lowest point in the late seventies.

This has directly affected the age profile of the U. S. housing relevant population, and its pattern over the next twenty years. In Table 2, abstracting from major changes for morbidity and international migration, we have projected the population levels by age groupings from 1990 through 2010. A careful examination of these data suggests that in the decade of the 1990s a significant decline (approximately 15 per cent) in the

age group between 25 and 34 will reduce the overall pressures of housing demand. We would expect that annual housing demand will decline over the 1990's by 15 per cent from its 1980's peak.

However, the decline in the population growth rate with its impact on housing demand and housing prices is likely to differ significantly across regions. Tables 3 and 4 contain actual and projected regional distributions of population for the United States from 1960 through 2010. Important demographic shifts are expected to continue to expand the populations of the West and Southern parts of the United States vis-a-vis the Northeast and Mid-West. This population expansion implies significant growth in housing demand in these areas, with the result that these regions are likely to experience relatively higher housing prices over the long haul as compared to the other regions.

Finally, Tables 5 and 6 suggest that the demand for housing will not decline proportionally with the decline in the growth rate of population. Besides regional shifts, there are other underlying demographic trend changes. Table 5 demonstrates that the typical household size is continuing to decline, and therefore housing units per thousand of population will not decline at the same rate as population growth. (This will produce increased housing demand at each level of population growth.) Among other things, the cause for this declining housing size relates to the increased rate of divorce as well as the declining death rate (see Table 6).

In summary, the housing crunch of the 1980's is likely to be mitigated by the slowing national population growth rate.

However, it is likely that we will experience significant regional differences in terms of housing demand and attendant price behavior. There could be, of course, further influences by regional economic cycles.

III. Home Ownership: Affordability and Changing the FHA Insured Mortgage Limits

The affordability of housing over time has been a changing and often a confused concept. In the 1970s, in the rapidly appreciating housing markets, there was a clear difference between the current costs of homeownership and the effect of "capital gains" in the asset. During this period, the affordability crisis was a cash flow problem caused by the traditional level of mortgage payments and the inability of households to monetize their expected or actual capital gains in the housing. Since 1980, however, this has changed. The 1980's decade has been characterized by high real interest rates combined with variable housing appreciation rates within and across regions, and has created from time to time both a current cash-flow and capital cost affordability crisis, especially for first-time home entrants.

S.565 and S.566 propose to adjust FHA mortgage insurance limits in order to recognize regional differences in housing markets. In principle, this is equitable and appropriate. It reflects the facts that at any point in time housing costs and prices differ substantially across various geographical areas in the United States.

If loan limits were increased, as proposed, to 95 per cent (or 97 per cent for first-time home buyers) of the area's median

housing price, in parts of California, this would change the FHA insured loan limit to approximately $180,000. If we were to apply standard borrower qualification measures, this would require households to have incomes in excess of $75,000.

A policy for changing the regional limits would particularly assist first-time home-buyers with substantial current incomes but who have not accumulated significant down payments. These households would be able to afford ownership at a higher level of housing consumption than might be possible otherwise. It would, also, add demand to the housing market, giving housing prices an upward buoyancy.

Against these social benefits, policy-makers need to weigh the potential social costs. The single best determinant of mortgage default is the loan-to-value ratio of the mortgage. FHA (and VA) mortgages are very high debt-to-value loans in comparison to typical conventional mortgages. As can be seen in Tables 7 and 8, FHA insured loans tend to have significantly higher delinquency and foreclosure rates vis-a-vis conventional private market mortgages. Increasing the regional mortgage limits, especially in the expensive housing markets, may engender a new set of high income households with low down payment (i.e. high debt-to-value) mortgages that exhibit high default and payment delinquency risks.

Should Government be willing to subsidize such loans? Is the private mortgage insurance industry not willing or unable to undertake these risks? What resource trade-offs does the change in FHA regional loan limits imply for the housing for low-income

households and the homeless? These are the types of issues that need to be explored and quantified in terms of benefits and costs for directing housing policy of the 1990s.

IV. The Future Path of Housing Policy

While there is reason to be optimistic about the resource requirements for housing in the future because of the slowing growth of population, housing policy still has a difficult and complex set of tasks ahead. To the extent that home ownership is a goal of housing policy, there are, at least, four major obstacles which impede this policy path. First, and also, paradoxically, the lowering of tax rates along with the increased standard deduction in the 1986 Tax Reform Act reduce the benefits of interest and property tax deductibility. Hence, the cash-flow economic advantages of home ownership at the margin are less attractive. Second, the economies of the United States and the World are significantly more volatile than they used to be. This phenomena increases economic risks which, in turn, make the ownership of long term assets, as in this case, houses, more risky. One only has to think of the recent boom/bust cycles of the oil patch to recognize the potential risks of owning capital assets, including real estate. Unfortunately, regional cyclical and general economic variability are probably increasing, thereby intensifying the risks of ownership. Thirdly, the financial markets crises, as highlighted by the FSLIC bailout and the unanticipated need for Congressional funding of the V.A. Revolving Loan Program, will have special impacts upon the housing finance system. The likely outcome is that the real

costs of borrowing for home ownership over the long run will increase significantly. This, too, will reduce the economic incentives for home ownership. Finally, increased regulatory controls of real estate at the Federal, state and local levels (i.e., land use controls, growth controls, user fees, environmental regulation, and so forth) will tend to increase the supply cost for housing. In the long run this must be translated into higher real costs borne by the buyers and owners of housing.

It is time to re-examine and re-fashion national housing policy. S.565 and S.566 are a good step in this direction. The goals of housing policy should be to re-establish programs to:

1) assist the demand side of housing where necessary, especially, for the low-income groups;

2) reduce the cost of supplying (producing) houses; and

3) determine appropriate overall public sector resource and equity trade-offs for housing and other policy alternatives.

Table 1: Births Per Annum, 1960-1980.

Year	Total Births (000's)	Births Per 1000
1960	4258	23.7
1965	3760	19.4
1970	3731	18.4
1975	3144	14.6
1976	3168	14.6
1977	3327	15.1
1978	3333	15.0
1979	3494	15.6
1980	3612	15.9
1981	3629	15.8
1982	3681	15.9
1983	3639	15.5
1984	3669	15.5
1985	3761	15.8
1986	3757	15.6
1987	3829	15.7

Source:U.S. Bureau of the Census, Population Reports, series P-25.

187

Table 3: Regional Population Distribution of the U.S., Actual and Projected, 1960-2010

Population in Thousands

Year	Total	By Region			
		North-East	Mid-West	South	West
1960	179323	44678	51619	54973	28053
1970	203302	49601	56589	62812	34838
1980	226546	49135	58866	75372	43172
1990	249891	50577	59777	87276	52261
2000	267747	51810	59596	96919	59422
2010	282055	52496	59018	104919	65622

Source:U.S. Bureau of the Census,Current Population Reports, Series P-25

Table 2: Projected Population Levels, Distribution and Percent Change, for 1990, 2000, 2010, by Age Group.

Age Dist'n	Population Projections in 1000's			Population Distribution in %			Percent Change From Previous Decade		
	1990	2000	2010	1990	2000	2010	1990	2000	2010
Under 5	18408	16898	16899	7.4	6.3	6.0	11.8	-8.2	0.01
Bet.5&17	45630	48815	45747	18.2	18.2	16.2	-3.4	7.0	-6.3
Bet.18&24	26140	25231	27155	10.4	9.4	9.6	-13.9	-3.5	7.6
Bet.25&34	43925	37149	37572	17.5	13.8	13.3	16.7	-15.4	1.1
Bet.35&44	37897	43911	37202	15.1	16.4	13.2	46.5	15.9	15.3
Bet.45&54	25487	37223	43207	10.2	13.9	15.3	12.0	46.0	16.1
Bet.55&64	21364	24158	35430	8.5	9.0	12.5	-1.8	13.1	46.7
Bet.65&74	18373	18243	21039	7.3	6.8	7.4	17.4	-0.7	15.3
At&Over75	13187	16639	18323	5.3	6.2	6.5	31.2	26.2	10.1

Source: Statistical Abstract of the United States,1989, Tables No. 57 and 58.

22-940 O - 90 - 7

Table 4: Regional Population Distribution of the U.S., Actual and Projected, 1960-2010

Population in Percent

Year	Total	By Region			
		North-East	Mid-West	South	West
1970	100	24.1	27.8	30.9	17.1
1980	100	21.7	26.0	33.3	19.1
1990	100	20.2	23.9	34.9	20.9
2000	100	19.4	22.3	36.2	22.2
2010	100	18.6	20.9	37.2	23.3

Source:U.S.Bureau of the Census,Current Population Reports, series P-25

Table 5: U.S. Household and Family Size, 1960-1988.

Year	Households		Average Family Size
	Total (in 000's)	Avg. Size	
1960	52799	3.33	3.67
1970	63401	3.14	3.58
1975	71120	2.94	3.42
1980	80776	2.76	3.29
1985	86789	2.69	3.23
1986	88458	2.67	3.21
1987	89479	2.66	3.19
1988	91061	2.64	3.17

Source: U.S.Bureau of the Census, Population Reports, series P-20.

189

Table 6: United States
Deaths and Divorces, 1960-1987.

Year	In 000's		Per Thousand	
	Total Deaths	Total Divorces	Deaths	Divorces
1960	1712	393	9.5	2.2
1965	1828	479	9.4	2.5
1970	1921	708	9.5	3.5
1975	1893	1036	8.8	4.8
1976	1909	1083	8.8	5.0
1977	1900	1091	8.6	5.0
1978	1928	1130	8.7	5.1
1979	1914	1181	8.5	5.3
1980	1990	1189	8.8	5.2
1981	1978	1213	8.6	5.3
1982	1975	1170	8.5	5.0
1983	2019	1158	8.6	4.9
1984	2039	1169	8.6	5.0
1985	2086	1190	8.7	5.0
1986	2105	1159	8.7	4.8
1987	2127	1157	8.7	4.8

Source:U.S. Bureau of the Census,
Current Population Reports, series P-25.

Table 7 Mortgage Delinquency Rates By Type Of Loan
For One-To-Four-Family Residential Non-Farm Homes

	Delinquency Rates (Per cent of loans 30 days or more late)		
	Conventional Loans	VA Loans	FHA Loans
1970	1.74	3.03	3.68
1975	2.71	4.17	5.45
1980	3.09	5.33	6.56
1985	4.05	6.63	7.46
1987	3.15	6.21	6.56

Source: U.S. Bureau of the Census, Statistical Abstract of the United States: 1989, Washington, D.C., Table Number 812

Table 8: Mortgage Foreclosure Rates By Type Of Loan
For One-To-Four-Family Residential Non-Farm Homes

	Foreclosure Rates (Per cent of loans in the foreclosure process at year end)		
	Conventional Loans	VA Loans	FHA Loans
1970	.08	.50	.40
1975	.16	.16	.46
1980	.17	.46	.53
1985	.61	.88	1.01
1987	.67	1.28	1.44

Source: U.S. Bureau of the Census, Statistical Abstract of the United States: 1989, Washington, D.C., Table Number 812

The ALLIANCE To Save Energy

1725 K Street, N.W.
Suite 914
Washington, D.C. 20006-1401
202/857-0666
Fax: 202/331-9588

Chairman
Senator Timothy E. Wirth
Co-Chairman
Senator John Heinz
Daniel J. Evans
Charles H. Percy
Executive Director
Thomas P. Habershon
General Partner
Trillo-Cook & Co.

Board of Directors

Norman R. Augustine
Chairman and CEO
Martin Marietta Corporation
Joseph A. LaSala, Jr.
Managing Partner
Price Waterhouse (Retired)
Partner and Board
Lane and J. Carbaugh
General President
United Mine Workers International Association
Robert S. Litan
Director and CEO
Brookings Institution Public Affairs Institute
Arthur J. Hill
Chairman and CEO
Golden Gallon Food Stores Group
George H. Lawrence
President
Union Pacific Corporation
Mildred B. Machado
Member Board of Director
American Association of Retired Persons
William McCollum, Jr.
President
Edison Electric Institute
Richard L. Metzler
Vice President
Credit Lyonnais
Harold O. Maxwell
Chairman and CEO
Exxon, Inc.
Russell B. Peterson
President Emeritus
National Audubon Society
Richard Siegenthaler
President & CEO
Lime of Corporation
Irwin M. Weber
Energy and Environmental Policy Center
Harvard University
Robert H. Yarbrough
Charles Allen and Robert Hazard Professor
of Business Administration
Harvard Business School
R. Roger Warden
Vice President
Corporate Environmental Programs
General Electric Company
Albert Thumann
Executive Director
Association of Energy Engineers
Russell E. Train
Chairman of the Board
World Wildlife Fund/The Conservation Foundation
Stephen Wiel
Chairman, Energy Conservation Committee
National Association of Regulatory Utility Commissioners
James L. Wolf
Executive Director

TESTIMONY OF BARBARA BANNON-HARWOOD
PRESIDENT, BBH ENTERPRISES, INC.
ON BEHALF OF
THE ALLIANCE TO SAVE ENERGY
BEFORE THE
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
COMMITTEE ON BANKING, HOUSING,AND URBAN AFFAIRS
UNITED STATES SENATE
JUNE 9, 1989

I appreciate the invitation to testify before the Committee regarding the role of energy efficiency in housing affordability, as it relates to S. 566, the National Affordable Housing Act. Many facets of this legislation have major implications for the low- and moderate-income buyers and renters I serve. My company, BBH ENTERPRISES, INC. in Dallas, Texas, builds homes for low- and moderate-income buyers that are the most energy efficient and most affordable in the Dallas marketplace. We also rehab low-income apartments (some Section 8 and Rental Rehab), and plan to rehab a 60-year old building into a Single-Room-Occupancy dwelling for the homeless. All of these projects include state-of-the-art, cost-effective energy efficiency features.

The Alliance to Save Energy is a national nonprofit coalition of government, business, and consumer leaders dedicated to increasing energy efficiency. We believe energy efficiency is a vital part of the affordable housing formula.

My testimony is based on my own experience as a homebuilder, a rehabber, and an advocate for and counselor to low-income families who buy our homes or rent space in our buildings. I have also been very involved in low-income housing advocacy through many Dallas organizations over the last five years, including service on the Mayor's Task Force for Low-Income Housing, and the Housing Committee of the Greater Dallas Community of Churches.

I have also been actively involved with the national policy initiatives the Alliance to Save Energy has launched on energy and affordable housing. The Alliance's recent report **Making Housing More Affordable Through Energy Efficiency** shows that policies to encourage higher-efficiency homes can make housing more affordable.

EXPANDING HOMEOWNERSHIP THROUGH ENERGY EFFICIENCY

The focus for today's roundtable discussion is homeownership. In this context, I want to show the role energy efficiency can play in expanding homeownership opportunities.

As an example, I will use a home we build. It is 1120 square feet, 50% brick exterior, and sells for about $39,000 to families earning less than 80% of the Dallas area median income. These are financed through innovative public-private partnerships, involving as many as eight players, including corporate sponsorship from sources like Texas Utilities (see appended descriptions of Country Village and Noah's Landing).

I increase the energy efficiency specifications for my homes such that they use at least a third less energy than homes built to standard Dallas building practice. The standard practice calls for R-11 walls, R-19 ceilings, standard asphalt-plywood sheathing, single pane windows, and minimal caulking. My plans specify R-16.6 walls (1/2 inch polyisocyanurate foamboard sheathing, taped and sealed to reduce air leakage, plus standard R-13 fiberglas batts), R-30 ceilings, radiant barriers, double-pane windows and patio doors with polywrap interior taping to reduce air leakage, insulated hot water pipes in the slab and inside walls, insulated cold water pipes in outside walls, sills caulked and sealed, and three-stage caulking (in three colors) to reduce shrinkage.

These energy features add $862 to the cost of the home. But the more-efficient building envelope allows us to use a smaller heat pump (1 1/2 tons of cooling capacity versus 2). This saves us $600; so the net cost of the energy improvements is $262. In a 10 1/2%, 30-year mortgage, this adds $2.40 to monthly payments. But the families living in these homes are saving $30-60 per month depending on the season. Thus the total cost of occupying our higher-efficiency home is lower than the cost of standard homes.

If the mortgage financing system recognized this simple arithmetic, we could lower the qualifying income for such energy efficient homes and thus expand homeownership opportunities. For example, our example home, with a

subsidized, no-interest second mortgage would require an income of $14,980 at today's interest rates. But if the lender credited the mortgage payment with $30 in energy savings, the qualifying income would drop to $13,694. This would make our homes affordable to more families!

Research by the Alliance to Save Energy and the Harvard/MIT Joint Center for Housing Studies has shown that if this approach were taken nationwide, we could expand the pool of qualifying first-time homebuyers by as much as 22%. This means that up to 250,000 more families could buy homes! This is a significant number, but the numbers alone are not what matters. These are families shut our of the homebuying market, typically earning less than the median income. They are headed by the men and women who teach our children, who repair our refrigerators and power lines, who fix our cars and lawnmowers, who type our letters and run our offices, and who cook and serve our food in restaurants. These are the kind of families we all grew up next door to -- except now they are being squeezed out of the American dream of homeownership. A simple act of Congress that makes uses of energy efficiency to expand homeownership could give a quarter million of these families a chance to own homes.

REDEFINING AFFORDABILITY

Why isn't this happening? Why aren't more energy-efficient homes like this being built and sold today? Because our conventional definition of housing affordability focuses exclusively on first cost -- purchase price. Virtually all national affordable housing initiatives seek to do one thing -- lower the price of homes. This approach is correct within its assumptions. But these assumptions fail to recognize that in reality affordability is determined by first cost plus operating costs. This reality is felt especially keenly by low-income people, who pay as much of a third of their housing costs for energy, and by senior citizens, whose energy bills can exceed the payments on their older mortgages. But it is also felt by young families trying to buy homes and then make ends meet each month. When a few extra dollars in the mortgage buys $30-60 in lower energy bills, the the benefits of energy efficiency are plain to see.

This too-narrow view of affordability is perpetuated by the mortgage lending process, which does not effectively factor energy into underwriting formulas. Conventional financing requires no inclusion of energy costs in underwriting. The standard mortgage payment/gross income ratio includes no operating costs. The Federal Housing Administration (FHA) has included an energy cost estimate in the monthly housing expense used to calculate qualifying ratios; the Department of Veterans' Affairs (DVA) loan application process also

includes an energy cost figure. But both FHA and DVA have used standard tables for energy costs: the figures in these tables are averages, and do not relate to the individual home being financed. This approach can't factor energy efficiency into the underwriting, because it can't give credit to efficient homes or penalties to inefficient homes.

I don't fault the mortgage banking community for this problem; they are not being given the right signals and incentives to fully integrate energy into the underwriting process. It is the job of Congress, the Administration, and the secondary markets to send the right signals to local lenders.

PROBLEMS WITH PREVIOUS POLICY INITIATIVES

The policy implication from this is that mortgage lending practices should take better account of energy costs in determining the affordability of a given home. In fact, in the 1970s an attempt was made to do this. Presidential Executive Order 12185 dated December 17, 1979 (copy appended) required all federal agencies with financial assistance programs to come up with ways to conserve energy through those programs. This caused FHA, DVA, and the Farmers Home Administration (FmHA) to develop policies to encourage energy efficiency. Fannie Mae and Freddie Mac, while not legally bound by the order, also took steps in this direction.

The results were mixed. What emerged from the attempts to comply with the Executive Order was a patchwork of policies with no consistency, several administrative problems, and very little public awareness. To summarize the situation:

- Fannie Mae and Freddie Mac established a two-pronged energy efficiency policy. One allowed lenders to use higher payment-to-income ratios when underwriting loans on homes that were rated energy efficient. The other allowed buyers of existing homes to roll the cost of improvements into their first mortgages. This required buyers to arrange for the improvements before closing, and required lenders to create escrow accounts from which to pay for the improvements after the buyer moves in.

- FHA and DVA set up policies that allow buyers to add up to $3500 worth of energy improvements to their loans. However, FHA and DVA have no provisions for relaxing underwriting guidelines for homes that are already energy-efficient.

- FmHA established strict energy efficiency standards for the homes it finances, and included energy costs as part of its loan application review process.

These initiatives were positive steps, but the experience of people like myself trying to use them at the local level is that they must be fully integrated into the mortgage finance system. To synopsize some of the problems that have emerged with the use of these programs:

- Consumers are largely unaware of these programs. They are not told about them when they purchase the house, or when they apply for mortgages. FHA and DVA mention the energy provisions, but in fine print in obscure locations on appraisal certificates, which the buyer usually receives too late to act on them! Even I, who have been working in this area for a decade, learned about a the FHA/DVA options last week! Neither are there any broad based information programs that would cause consumers to ask for these programs.

- Primary (local) lenders are as unaware of these programs as consumers. The programs exist mainly as modest paragraphs in regulations and loan underwriting guidelines. They are not part of the daily awareness of most mortgage lenders. This is partly because they were created 5-10 years ago and have not been promoted since. It also results from the vast gulf between Washington-generated policies and the real world of local lenders. These programs include neither requirements nor incentives to interest local lenders in using them.

- The programs are often difficult to use. Their rules are inconsistent and confusing. What Fannie Mae allows, DVA disallows, and so on. Those trying to launch an effort at the local level are stymied by these complex and conflicting requirements.

RECOMMENDATIONS FOR S. 566 RELATING TO ENERGY EFFICIENCY

Both the Alliance to Save Energy's appended report and the National Association of Homebuilders' recent resolution (copy appended) call for streamlining the mortgage financing system to better integrate energy efficiency into the loan underwriting process. A consensus is building that national housing policy should use the benefits of energy efficiency to make housing more affordable.

Title II -- Homeownership

The National Affordable Housing Act can further expand opportunities for homeownership by adding an energy efficiency section to Title II. This section should contain two provisions: one to create a national Uniform Energy Efficient Mortgage Program, and another to create procedures for disclosing this program to mortgage applicants and for informing consumers, local lenders, and real estate professionals about it.

(a) **Develop a Uniform Energy Efficient Mortgage Program.** The Secretary of Housing and Urban Development, in consultation with the Secretary of Energy, shall within two years of the passage of the National Affordable Housing Act (NAHA), promulgate a plan to create the "Uniform Energy Efficient Mortgage Program". The goal of this plan shall be to reduce homeowners' total housing costs by financing energy efficiency improvements in mortgages. To develop this plan, the Secretary shall form a task force to make recommendations on financing energy efficiency in private mortgages, through the policies of federal agencies and federally-chartered institutions. The task force shall include federal home mortgage insurance and guarantor agencies, federally-chartered mortgage institutions, mortgage bankers, homebuilders, real estate brokers, private mortgage insurers, energy suppliers, and nonprofit housing and energy organizations. It shall evaluate the existing energy policies of the Federal National Mortgage Association (Fannie Mae), The Federal Home Loan Mortgage Corporation (Freddie Mac), The Federal Housing Administration (FHA) and the Department of Veterans Affairs (DVA). It shall also evaluate the use of home energy rating systems in conjunction with these energy policies, and shall make recommendations for streamlining and promoting the use of such programs. The task force shall report to the Secretary and make public its recommendations within one year of the passage of NAHA. $500,000 shall be authorized to support the work of the task force.

(b) **Disclose energy financing options at time of mortgage application.** Beginning two years from the passage of NAHA, all home mortgage loan originators whose loans are purchased, insured, or guaranteed by federal agencies or federally-chartered institutions shall, at the time of loan application, disclose to each applicant the availability of the Uniform Energy Efficient Mortgage Program through these agencies or institutions, and shall act in a timely fashion to assist applicants in using these incentives. The Secretary of Housing and Urban Development shall at the same time launch an educational program to inform the public, mortgage lenders, and real estate professionals about this program.

Other Energy Efficiency Recommendations

While my testimony focuses on the benefits of energy efficiency in expanding homeownership, the affordability impact of energy costs is much greater in rental housing than in owner-occupied housing, and in existing homes than in new homes. I urge the Committee to incorporate provisions in the other titles of the National Affordable Housing Act that address rental housing and existing housing.

The greatest need for energy efficiency is in existing low-income rental housing. More than 60% of people below the poverty line are renters, and more than two-thirds of them pay more than 50% of their income on housing (including energy costs). These families pay more than a third of their housing expenses for energy, versus about the 20% of housing expenses that average households pay for energy. Since so much of their housing costs go for energy, efficiency gains can be of greater help to low-income renters than to other groups.

We recommend that minimum energy efficiency standards be established for housing created or rehabbed with federal assistance. These standards should, as a minimum, reference the Council of American Building Officials' Model Energy Code. Also, the Act should create incentives for housing developers receiving federal assistance to add energy measures above minimum code requirements, when doing so would reduce the total housing expenses of buyers or renters.

RECOMMENDATIONS FOR S. 566 -- UNRELATED TO ENERGY EFFICIENCY

Title I, Section 105 -- State and Local Housing Strategies

The National Affordable Housing Act's provision calling for states and localities receiving CDBG funding to submit comprehensive affordable housing strategies is excellent. It forces local authorities to develop long-term policies instead of wandering haphazardly into uncoordinated programs. I urge you to stipulate maximum citizen involvement in this strategy-making process. States and localities should be required to hold public hearings to receive input from citizens, tenant groups, housing advocates, and neighborhood groups, and to permit citizen monitoring and evaluation of the planning process.

Title II, Section 202 -- FHA Amendments

The provision for lowering FHA down payments to 3% on the first $50,000 is excellent; but for low-income families, it may not be enough. In Dallas' program, developed with a local bank and Fannie Mae, families earning less than 50% of median income can put down $1000. Closing costs are paid out of a soft-second mortgage program called LIMA (see appended description). In structuring this program, we felt that for families which are often single parents with children, saving $1000 is an adequate demonstration of responsibility when the household income is below $20,000.

Title III -- Investment in Affordable Housing

Establishing a new HOME Corporation in HUD is an excellent idea if, and only if, there is a serious "merge and purge" of other HUD programs. We don't need more bureaucracy, but we desperately need better coordination among the programs that already exist. If the Act merely adds the HOME Corporation's programs to the HUD bureaucracy <u>without</u> a meaningful "merge and purge", we are doomed!

Here is an example of what I mean. Under CDBG guidelines, section 570.207(b)(4), downpayment programs for low-income families are permitted "provided a national objective is met". Many low-income families in Dallas who qualified as homebuyers based on income and credit reports were unable to buy because of high downpayments. Dallas County set up a program to assist with downpayments, and the City Housing Department established the Low-Income Mortgage Assistance (LIMA) program. LIMA provides up to $15,000 to buy down mortgages and pay closing costs. HUD's legal department disallowed the County downpayment program because they weren't sure a "national objective" was being met. They questioned the LIMA program for the same reason, and another HUD office has said that families using LIMA must live in certain targeted areas. It does not matter where these families now live; if they are <u>low-income</u>, they will only be able to buy low-cost housing anyway, regardless of its location. Such arbitrary geographic restrictions are counterproductive.

My final recommendation for the HOME Corporation is that for any program created under its aegis, there should be a single "buck-stops-here" point of accountability for all aspects of the program. List the individual accountable for each program, with their phone number, on all documents issued under the program.

Title III, Subtitle A -- The HOP program

The provision that all homeownership projects under HOP must meet "income and other targeting requirements adopted for Nehemiah Housing Opportunity Grants", conflicts with the provision in Title II that reduces FHA downpayment requirements. Nehemiah requires 10% downpayments, which is why nobody I know uses it. For a low-income family to save 10% of a $40,000 house would require either a miracle or a Scrooge confiscating their paycheck and letting them starve.

Also, the Nehemiah "neighborhood approval" requirement creates a problem in many areas. It is all well and good to let neighborhoods instigate their own rehabilitation -- this works in many cities. But in cities like Dallas, there are large, diffuse blue-collar areas with inexpensive land suitable for low-income housing. The attitude that prevails among blue-collar whites in these areas is that all low-income people are black criminals. This creates an almost impenetrable "NIMBYism" in such areas.

Nehemiah regulations also set minimum size-of-development rules that would, for example, require me to build 250 low-income homes in one location. It is very hard in our area to find enough land in one parcel to build 250 homes, and the neighborhood opposition rises with the size of the development.

Nehemiah also requires than no construction or rehab can begin until at least 25% of the homes are contracted for sale and downpayments have been made. First, it is <u>very hard</u> to sell without a model, and you can't build a model until you begin construction. If 250 units are required, you have to sell 63 before lifting a shovel. If you have to buy the land, do the engineering, architecture, and other preliminary work, plus maintain a sales operation, until 63 units are sold, I GUARANTEE no low-income homes will be built. The upfront costs would be too great. Clearly, builders were not involved in writing the Nehemiah regulations. I hope we will be heard when the HOP rules are written.

I have one simple recommendation in this area: PLEASE DO NOT USE THE NEHEMIAH GUIDELINES IN THE HOP PROGRAM!!

Title III, Subtitle B -- Mortgage Credit Enhancement

This is an especially pressing need for mortgages on multifamily low-income housing. I am working with the Greater Dallas Community of Churches Housing Committee, the Center for Housing Resources, and Common Ground, two local nonprofits, to accumulate a large number of low-income apartments which can be bought now at discount prices and

maintained as low-income housing for 20 or 30 years. We are working with a large national insurance company, Fannie Mae, and are searching for a private banking partner. I have been told that if there were a secondary market for these loans, finding the private partner would be no problem. I urge the Committee to sustain the credit enhancement provisions of the Act.

BUDGETARY IMPACT

I applaud and fully support the funding proposed in the Act. to paraphrase, the deficit will always be with us, but the homeless must be provided for.

Thank you for the opportunity to discuss these issues with the Committee. Thank you, too, for serving ALL Americans by recognizing that this country is only as strong as the weakest link in the chain of self-rule for which a democracy provides.

WHERE DID THESE PROGRAMS COME FROM?

Executive Order 12185 of December 17, 1979

Conservation of Petroleum and Natural Gas

1-101. Each Federal agency, as that term is defined in Section 102(a)(38) of the Powerplant and Industrial Fuel Use Act of 1978 (92 Stat. 3297), shall effectuate through its financial assistance programs the purposes of that Act relating to the conservation of petroleum and natural gas.

1-102. Each Federal agency which extends financial assistance shall review those programs of financial assistance and identify those which are most likely to offer opportunities for significant conservation of petroleum and natural gas.

1-103. Within two months, and annually thereafter, each agency shall publish for comment a list of those programs which it has identified as likely to offer significant opportunity for conservation. The public shall be given 60 days to submit comments, including suggestions for rules which would effectuate the

EXECUTIVE ORDER 12-185-DEC. 17 1979
1-102 EACH FEDERAL AGENCY...SHALL IDENTIFY THOSE PROGRAMS...WHICH ARE MOST LIKELY TO OFFER OPPORTUNITIES FOR SIGNIFICANT CONSERVATION OF PETROLEUM AND NATURAL GAS.

1-107. To the extent permitted by law and where not inconsistent with the financial assistance program, final rules may provide for the reduction or suspension of financial assistance under any award. Such reduction or suspension shall not be ordered until there has been an opportunity for a hearing on the record, and shall last for such time as the recipient fails to comply with the terms of the conservation rule.

1-108. No conservation rule shall be adopted which is inconsistent with the statutory provisions establishing the financial assistance program.

1-109. No conservation rule shall be used to enforce compliance with any prohibition under the Act against any person or facility which has been specifically determined by the Secretary of Energy as subject to or exempt from a prohibition under the Act. The conservation rules shall be used to enforce other new ways of achieving the purposes of the Act related to the conservation of petroleum and natural gas.

1-110. In order to assess the effectiveness of this program, each agency shall annually prepare a report on its activities in accord with Section 403(b)(1)(B) of the Act. These reports shall be submitted to the President through the Secretary of Energy.

1-111. The Secretary of Energy shall prepare for the President's consideration and transmittal to the Congress the report required by Section 403(c) of the Act.

1-112. The Director of the Office of Management and Budget may issue any rules, regulations, or orders he deems necessary to ensure the implementation of this Order. The Director may exercise any of the authority vested in the President by Section 403(b) of the Act, and may redelegate such of that authority as he deems appropriate to the head of any other agency.

THE WHITE HOUSE,
December 17, 1979

Resolution No. 15

Date: January 19, 1989
City: Atlanta, Georgia

NAHB Resolution

Title: Recognition of Energy Efficiency in Affordable Housing
Original Sponsor: Standing Committee on Energy

WHEREAS, the Congress will be considering legislation to address the need to provide decent, affordable housing to America's lower-income families;

WHEREAS, next to monthly mortgage payments, utility bills are the second largest expense to the buyer;

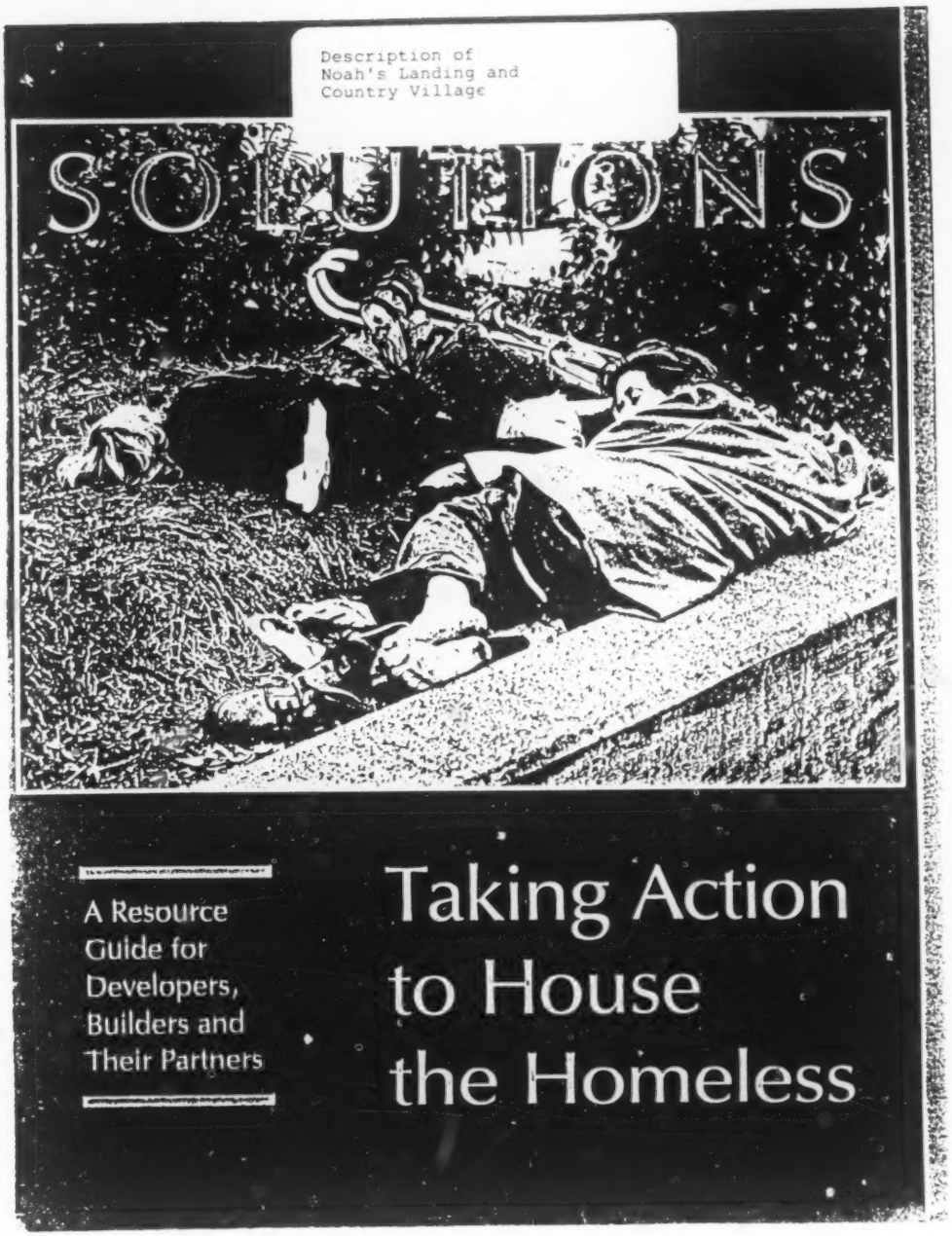
WHEREAS, the National Association of Home Builders recognizes that the cost of operating a house is as important to lower-income families as the initial purchase price; and

WHEREAS, NAHB has recognized that lower monthly energy operating costs can allow for higher debt-to-income ratios on mortgages, which will qualify more first-time home buyers,

NOW, THEREFORE, BE IT RESOLVED that the National Association of Home Builders encourage the Congress and the Administration to take into account the monthly savings achieved by energy efficiency measures when drafting the federal legislation to promote construction of decent, affordable housing.

Board of Directors Action:	Approved
Joint Executive/Resolutions Action:	Recommends Approval
Resolutions Committee Action:	Recommends Approval
Standing Committee on Energy Action:	Recommends Approval

Description of
Noah's Landing and
Country Village



Country Village Project

Background

Barbara Harwood's two projects, Country Village and Noah's Landing, are a natural outgrowth of her longtime involvement in energy-efficient housing.

Her interest in energy-efficient housing began in 1979, when Harwood, then a journalist for the *Chicago Sun-Times*, was assigned to cover stories on energy and housing. For one of those stories, Harwood visited an elderly couple who lived in an earth shelter in Central Illinois. Thanks to the energy-efficiency of their home, this couple maintained a comfortable temperature with minimal expense for energy—only $30.00 a winter (the cost of a half-cord of firewood).

Shortly after visiting the first couple, Harwood encountered another elderly couple whose lives were starkly different. This second couple received the same Social Security check as the first, but was literally going hungry to pay utility bills in a home so leaky and energy inefficient that they couldn't keep it warm. Harwood was struck by the difference—one couple keeping warm and happy with minimal expense, the other shivering through the winter despite paying high heating bills. The different lives of the two couples arose from only one factor—the energy efficiency of their homes.

From that point on, Harwood was fascinated by the concept of energy efficiency in low-income housing. She convinced her husband Richard's company, Northern Illinois Construction Co., to upgrade its energy specifications, began working on national energy issues, and became a member of NAHB's Standing Committee on Energy. She has remained a member of the Committee for nine years and is its immediate past Chairperson.

In 1983, Harwood and her husband moved back to her home state of Texas, and she began pursuing a new goal, producing energy-efficient, low-income housing. To achieve that goal, Harwood became involved in discussions on low-income housing in Dallas with the mayor, the director of the City Housing Department, and former developer James Rouse, who is Founder and Chairman of the Enterprise Foundation, a non-profit organization dedicated to creating affordable housing for the poor. The ideas and enthusiasm generated in those discussions increased Harwood's desire to take action. She started her own corporation,

BBH Enterprises in 1984, in order to realize her goal of building and developing energy-efficient low-income housing.

In the Fall of 1985, the mayor of Dallas appointed Harwood to his Low-Income Housing Task Force. The Task Force came out with a report recommending a program to produce affordable, for-sale housing for people that earn less than 80% of the median income for the Dallas area. Harwood decided to take on that recommendation as a personal challenge, and, at the same time, produce homes that would be energy-efficient as well.

The major problem for the city government at that time was the lack of reliable cost estimates. Without solid cost figures, city officials would be reluctant to support a large-scale project. As a result, Harwood decided to do a pilot project of three demonstration homes, and to open her books to the city once the project was completed. By examining her cost figures from the pilot project, city planners could determine how much contribution would be necessary from the city in future projects to produce a house at a given price.

Country Village Project Description

Country Village was designed to (1) provide housing for families earning less than 80% of the Dallas median income ($28,000/yr.): (2) demonstrate to City officials that good quality, energy-efficient housing could be built for that income group, and (3) to provide them with real numbers on construction, land and soft costs for their future planning.

Number of Units: 3

Size of Units: 2 units at 1,120 square feet, and 1 unit at 1,072 square feet

Total Project Cost: $157,596

Density of overall project: 4.5 units per acre

Hard cost of construction per square foot, excluding land: $26.59

Sales price of unit: $57,900—1,072 sq ft
$59,950—1,129 sq ft

Project Financing: $157,596 (100%) interim construction loan from the Dallas Housing and Economic Development Corporation. Loan had an interest rate of six percent which saved $1,000 per house.

Energy-saving features of the units

Harwood's units are substantially more energy efficient than the average Dallas house. They incorporate the following special features:

—Maximum passive solar orientation with large south windows shielded from summer radiation by a porch;

—½" polyisocyanurate sheathing, carefully patched by builder after plumbing and electrical openings were made;

—Dow sill sealer and caulking bead at sill plate;
—Three stage caulking and sealing at all openings;
—6 mil poly wrap vapor barrier over the 3½" fiber glass insulation in walls;
—10" blown fiber glass insulation in ceiling;
—Radiant barrier below roof decking;
—Ceiling fan in bedroom;
—Blanket around hot water heater;
—Steel insulated door;
—Double pane windows and patio door;
—High-efficiency heat pump.

By contrast, most Dallas homes use only plywood sheathing, have no poly wrap vapor barrier over the batts, and use only 6 inches of blown fiber glass in ceiling.

Harwood personally supervised the installation of the energy-saving products in each house. She firmly believes that strict attention to detail and quality control is an absolute necessity to insure that energy-saving equipment will operate as expected.

Cutting costs

The energy-saving features of Harwood's units turned out to be cost savers as well. Although the gross cost of installing the energy-saving features was $862 a unit, she saved $600 a unit on up-front costs, because the increased envelope specs reduced the amount of a/c tonnage she needed by a half ton. Harwood also got a $300 rebate from the local power company for having the most energy efficient building and equipment on their rebate chart. Thus, the installation of the energy features resulted in a *net* savings of $38 a unit.

Harwood points out that even if she had not received the energy company's rebate, the additional net up front costs to the buyer, $262, would be repaid in the first year of ownership, since the owners would be saving approximately $50 a month in utility bills.

In addition to the savings from the energy features, Harwood cut costs in several other ways. First, she took a reduced gross profit margin of 10%, as opposed to the usual 20-25%. Second, she conducted her own low-cost marketing campaign, which consisted primarily of distributing flyers and limited newspaper advertising. Third, she and her husband acted as the sales team, eliminating real estate agent commissions. Finally, Harwood enlisted the help of her family—one son did the art work on her flyers and a project logo, and another one conducted a marketing survey to obtain information on potential buyer needs and attitudes.

Marketing the units

Harwood posted her flyers in post offices, laundromats, schools, fire and police stations, and even left them on car windows. The flyer emphasized the affordable nature, low down payment and energy efficiency of the homes.

Once a prospective buyer came to view the units, Harwood used the energy-efficiency features of the units as a marketing tool. Harwood showed each prospective buyer an energy chart that showed projected utility bills in her homes side-by-side with projected figures for comparable, but non-energy efficient, units. To lend credibility to her figures, on the walls of each unit Harwood hung photography of the added energy-saving features of the unit taken while the features were being installed.

Harwood also used her own cost-cutting efforts to impress prospective buyers. In each unit, she posted a chart that showed savings that were being passed on to the buyer. For example, the chart showed prospective buyers that they were saving thousands of dollars because of Harwood's waiver of real estate commissions, her reduced profit margin and, the low cost of her construction loan.

Energy and cost savings were not the only selling points Harwood stressed to prospective buyers. Another key factor was house design. The builder designed these units with all the low-cost features possible to help working parents in home management. Some of the features Harwood stressed included:

—a tiled rear entrance or "muddy shoes depository" to prevent children from tracking mud onto the carpet;
—extra shelf space, conveniently located;
—kitchens arranged so a parent could do laundry, cook, supervise homework, talk on the phone, and/or unload groceries, all from one central area.
—a 50 gallon water heater (most low-cost homes have only a 40 gallon unit)

The three units were completed in February 1987. Priced from $57,900 to $59,950, they sold immediately. Harwood believes that such homes could be built at even lower cost if the city of Dallas would provide the land and help market the property.

Strategies for success

Harwood's pilot program was a success. Her three houses sold immediately. But to succeed with larger scale projects, Harwood cautions that a strategy for success is necessary. She suggests that such a strategy must include plans for networking, government relations, and proper mental attitude.

Networking with other low income housing advocates

For Harwood, the key to dealing with many of these obstacles has been the network of support she established early on. By participating on the Low-Income Housing Task Force and the Greater Dallas Community of Churches Housing Committee, Harwood now has a number of people she can call on for help. Harwood said:

"The work of the task force I served on was completed a year ago. But, all of us still do talk to each other and a lot of us are still working on the same issues. I get a tremendous amount of help and support from the people on the task force."

Harwood has also developed a national network of "experts" in housing issues who she can call on as "expert witnesses" when the going gets rough. As she puts it:

"The more of these contacts you can develop, the more likely you are to be able to find a 'creative solution' to a problem posed by bureaucrats"

Develop good relationships with representatives on local governing bodies

Harwood's active involvement in the community also has helped her establish credibility and good relationships with local officials. Harwood is active in several local energy and housing committees. She is also the recipient of the 1988 Community Action Award from the Dallas Housing Authority.

Harwood's thoughts echo experiences which are familiar to most builders and developers:

"You need trust and credibility, and a little power to use with discretion when the bureaucrats try to cut you off at the pass. According to my network friends, most local Housing Departments around the country see builders as the bad guys in black hats. They think builders are only in anything for the bucks, and there is a general level of distrust which really contaminates efforts to help with these affordable housing problems. The more builders get involved, the more that will be mitigated, but meanwhile if you encounter it, a little political muscle can get you over the pass without getting your horse shot out from under you."

Proper mental attitude

Harwood feels that a proper mental attitude consists of flexibility, creativity, and faith. She explains:

"You need flexibility. You have to be willing to change. You also need creativity. You have to be able to be creative enough to figure out what to do after someone tells you your plan has to be changed. Finally, you need faith in yourself, your abilities, and your guidance system, whatever it is, so that when things look the darkest, you can keep on going."

Noah's Landing Project
Dallas, Texas

PROJECT TYPE:
Energy-efficient single-family homes.

NUMBER OF UNITS:
102 Units

PROJECT FEATURES:
Cost savings from energy-efficient design and materials used.

FUNDING SOURCES:
CDBG funds from city for second mortgage, Fannie Mae
Single Family Home Ownership Program.

Looking ahead

Based on the successful sale of the Country Village units BBH Enterprises is planning a 102 unit development to be known as Noah's Landing. Through purchase of land at a foreclosure sale, lot costs will be reduced and homes at Country Village will be priced between $43,500 and $60,000.

Project financing

The City of Dallas will provide purchasers with second mortgages of up to $15,000 from Community Development Block Grant (CDBG) funds. Purchasers with incomes below 50 percent of area median will have soft second mortgages that are deferred until re-sale. Purchasers with incomes between 50-80% of median will make principal payments on loans with 0% interest.

NCNB Texas National Bank will provide mortgages at market interest rates which will be sold on the secondary market through the FNMA Single Family Home Ownership Program (SFHOP). SFHOP allows purchase of mortgages with soft seconds and low purchaser down payments. Purchasers with incomes between 50-80 percent of median provide a 5% down payment while those with incomes under 50% of median may make down payments of less than 5%.

Loan-to-value ratios can be increased for homes meeting NAHB's Thermal Performance Guidelines. Underwriting standards for energy-efficient homes will be increased to 30% of income (up from 28%) and 38% total purchaser debt (up from 36%).

Cost of Homes and Financing

	Two Bedroom	Three Bedroom	Four Bedroom
Total Sale Price	$43,444	$53,666	$61,333
Less Deferred 2nd Mortgage* (City CDBG loans)	15,000	15,000	15,000
	28,444	38,666	46,333
Less FHA 4% Down	1,194	1,766	2,083
To Be Financed At 9% (FNMA Single Family Home Ownership Program)	27,250	36,900	44,250
PI	219.26	296.90	356.04
Taxes and Ins. (Avg.)	100.00	100.00	100.00
Utilities (Avg.)	60.00	60.00	60.00
Total Monthly Cost	$379.26[1]	$456.90[2]	$516.04[3]

[1]Affordable to 4-person household making $15,000 per year (42% of median)
[2]Affordable to 4-person household making $18,000 per year (51% of median)
[3]Affordable to 4-person household making $20,600 per year (58% of median)
*Deferred until resale

Project data

Total Build Out—102 units, developed in phases of 18 units—2, 3, and 4 bedroom units.

	Average Unit	Total Development
Land Acquisition and Site Improvement	9,700	990,000
Construction	29,300	3,000,000
Soft Costs	7,600	775,000
Contingency (2%)	1,200	122,400
Builder's Gross Profit	5,300	540,000
TOTAL	53,100	5,428,000

Measures to reduce housing costs

- Units designed to modular widths and lengths (24" center increments) allow efficient use of material
- Kitchen and bathroom plumbing built around a central plumbing core.
- Material selection to reduce homeowner maintenance/service costs; also reduces builder service costs not covered by warranty.
- On-site quality control and supervision including scheduling avoids sub-contractor loss time.
- City waiver of no-tandem parking requirements.

The rewards of getting involved

Although Harwood's experience working on her two projects has been frustrating at times, they have also been very rewarding. Harwood said she has received letters from the families who now live in the Country Village Homes. Reading their comments like, "Our house is our dream come true. We never had any idea we could afford a nice house like this with such low utility bills", and "We and our children will be grateful to you for the rest of our lives" makes it all worth it.

Harwood is working with new groups of families now. As Harwood says:

"These are just simple Americans that need a helping hand to do what generations before them took for granted. When you're in a position to reach out your hand, it feels great.

You know, God gives us all talents and I think we have an obligation to use those talents the best way we can. If my talent is creative problem-solving, then it is my duty to use it to help those families."

"Barbara Harwood is the catalyst for the building of low and moderate income housing in Dallas. [She is] the only person who has taken the initiative. The rest of us are reacting."

Fred Roach, President
Centennial Homes, Inc.
Dallas

Barbara Harwood is President of BBH Enterprises, Inc. located in Dallas, Texas. BBH Enterprises, Inc., specializes in producing affordable energy-efficient housing.

Low-Income Mortgage Assistance (LIMA) Loan Program

PROGRAM DESCRIPTION

Community Block Grant dollars will be used to provide up to $15,000 per home, "soft second" with no or low interest, with amortization deferred, to cover the gap between the downpayment and the first mortgage, part of which may be used to cover closing costs, for families earning less than 80% of the median income for Dallas or the national median income, whichever is greater.

PURPOSE

To encourage homeownership by families who would not otherwise be able to afford homeownership.

To undertake a concentrated effort to rebuild the depressed areas of our city and to create sound and attractive neighborhoods for Dallas' low-income labor force.

EXTENT OF CONSTRUCTION

New construction or substantial rehabilitation which is defined as "involving costs in excess of 60 percent of the maximum sales price of the LIMA residence in the project, or rehabilitation of a vacant, uninhabitable structure."

MAXIMUM PUBLIC ASSISTANCE

Up to $15,000 per home.

ELIGIBLE APPLICANTS

Non-profit organizations who demonstrate they have consulted with and received the support of residents of the area where the program is to be located and who have an approved contract with each developer or rehabilitation contractor authorized to participate in the program.

PROGRAM REQUIREMENTS

- General eligibility - families who have not owned a home during the preceeding three years.
- Income eligibility - less than 80% of the median income for a family of four in the Dallas (SMSA) or the national median income for a family of four, whichever is higher. However, up to 15% of the families in a project may have incomes up to 100% of whichever median is used, provided that the developer demonstrates to the City that this is necessary to achieve or maintain neighborhood stability.
- Downpayment requirements - not less than 5% of the sale price, unless a lesser amount is allowed by the holder of the first mortgage, such holders to include private lending institutions, state or local governments or secondary market corporations.

- Rate and term of LIMA - the non-profit will apply LIMA funds to make a "soft second" mortgage of up to $15,000 to the purchasers.

  Payment shall be deferred until resale for families earning less than 50% of the whichever median is used, however families earning between 50% and 80% of the median shall repay the $15,000 at no interest in payments made monthly for the length of the first mortgage.

- Leasing prohibited - no family purchasing a LIMA home may lease said home.

- Restrictions on construction - except for models for display, construction may not commence until at least 25 percent of the homes in the project, or in a phase of the project if the developer is required to build a project in phases by the City of Dallas or the participating non-profit, are contracted for sale to purchasers who intend to live in said homes and a deposit, which shall be part of the downpayment, has been made. Model units for display are limited to not more than five (5).

- Maximum number of homes - up to 150 units per project.

- Area income restrictions - all LIMA project residences must be located in CDBG census tracts or identifiable neighborhoods within census tracts in which the median family income does not exceed 80 percent of the median family income of the area.

- Contiguous lots required - except that up to four identifiable neighborhoods with each having contiguous lots may be used if the developer certifies that land cannot be made available in a single neighborhood.

- Others - A LIMA can be subordinate only to a first mortgage held by a fully accredited lending institution. The loans will be due and payable upon the sale, lease or transfer of the home. The loan is transferable to another program, eligible families or person.

PROGRAM SELECTION CRITERIA

Selection shall be made on the extent to which:

- Public/private entities contribute land for the project,

- Public/private financial or other contributions including tax abatement, waiver or development fees, waivers of construction, development of zoning requirements as well as direct financial contributions,

- The greatest number of units for the least amount of public assistance,

- Each project is located in a neighborhood of physical and economic blight -- including the condition of the housing, other buildings and infrastructure,
- Each project uses construction methods that will reduce the square foot cost below the average construction cost for the area, and
- Each project provides for the involvement of local residents in the planning and construction process.

alhfa ASSOCIATION OF LOCAL HOUSING FINANCE AGENCIES
1101 Connecticut Ave., N.W., Suite 700 • Washington, D.C. 20036 • 202/857-1197

Officers

President
Walter D. Webdale
Fairfax County, Virginia

Vice President
Charles Brass
New York, New York

Secretary
Jay Jensen
Minneapolis, Minnesota

Treasurer
Barbara T. Smith
San Francisco, California

Immediate Past President
Kenneth Johnson
St. Paul, Minnesota

Directors

George Arendes
Allegheny, County, Pennsylvania

William R. Bruce
Memphis, Tennessee

Daniere Kaiser
Pinellas County, Florida

Angus T. Olsen
Alexandria, Virginia

David Perel
Los Angeles, California

Robert L. (Robb) Pitts
Atlanta, Georgia

Charles Taylor
Los Angeles County, California

ALHFA Staff

John C. Murphy
Executive Director

Mary Kate Uribe
Director
Program Development

Euzele C. Powell
Membership Services

Statement for the Record

By

David Perel
Housing Finance Officer
City of Los Angeles

on behalf of

The Association of Local Housing Finance Agencies
on The Homeownership Provisions
of S.565, The National Affordable Housing Act

June 9, 1989
Washington, DC

Thank you for this opportunity to testify on "Homeownership Affordability" in connection with the historic efforts represented by the proposed National Affordable Housing Act. I am Dave Perel, Housing Finance Officer for the City of Los Angeles and a member of the boards of the Association of Local Housing Finance Agencies and the California Association of Local Housing Finance Agencies.

The City of Los Angeles, as well as most of the members of ALHFA and CALALHFA, has had extensive experience in providing financing assistance to first-time homebuyers through mortgage revenue bond programs. In addition, many of these agencies, including the City of Los Angeles, provide additional assistance programs. In Los Angeles these include density bonuses for subdivisions which set aside units for moderate income households and deferred second mortgages for central city developments. The City is currently exploring a commercial development/affordable housing linkage program and an inclusionary housing program.

With an average home purchase price of approximately $190,000 and the lowest price for detached homes (in South Central Los Angeles) at $120,000, opportunities for homeownership are rapidly disappearing in Los Angeles. The decline in homeownership opportunities also means restricted availability of housing for families and restrictions on the filtering of housing stock. The latter is a process which has historically freed up lower cost housing for many households.

The increasing cost of housing in Los Angeles is also posing several additional impacts. Economic development is threatened by the inability of employees to find housing. Those able to purchase homes may only be able to do so in outlying areas, thereby exacerbating the problems of transportation, pollution, and other problems of urban sprawl.

Revisions in the FHA program cannot by themselves dramatically improve the ability of many families to purchase homes. But expansion of the ability of first-time homebuyers to purchase homes will be dependent on the availability of FHA insurance. With prices starting at $120,000, and rising rapidly beyond that level, FHA insurance with a loan limit of $101,250 has restricted utility.

Private mortgage insurance (pmi) is generally not an option for first-time homebuyers. If available for 95 percent loans, the qualifying criteria will disqualify most borrowers. Lower debt/income ratios will be employed, thereby necessitating higher borrower incomes. More rigorous income histories will be required (for example, several years on the same job!). The required initial and annual premiums add substantially to the closing costs and the pay rate on the loans. Insurance is not usually available for condominiums, the only affordable new housing available in Los Angeles, Orange County, San Diego, and the Bay Area.

Whatever the differential bases of their capitalization, private mortgage insurers apparently cannot underwrite risk while FHA can. Between 1980 and 1987, the City of Los Angeles financed approximately 1,500 units through its mortgage revenue bond program using three different private mortgage insurers and FHA insurance. This experience has underlined the limitations of private mortgage insurers and the critical role of FHA in qualifying first-time homebuyers.

The 1980 issue, with $23 million in mortgages still outstanding, was insured by TICOR Mortgage Insurance. With that company now in receivership there is no formal mortgage insurance. The City was unable to obtain a replacement insurance policy. Fortunately, the bond issue is backed by a bank letter of credit. The premiums now being collected are being used to fund a self-insurance pool.

The 1984 issue was insured by another insurer. When the first loans were submitted by the lender, the insurer initially refused to issue an insurance policy because it did not like the condominium project. In the absence of a contract dealing with project approval, the insurer agreed to insure loans in the projects only after threats were made to file a complaint with the state insurance commissioner and to more informally see to it that the company did not do any other business in the state. The mortgage insurer also imposed more restrictive loan underwriting criteria after the bond issue closed. Modifications in these new criteria were negotiated between myself and the company.

The 1985 issue was insured by a third insurer. In order to protect against loan underwriting criteria changes a supplemental contract was executed. Again, the insurer wanted to reject the projects (the contract was negotiated and the issue was closed before the project rejection issue had arisen in the 1984 issue). After some acrimony and claims and counterclaims, specific loan commitment levels were negotiated for each project. The central city projects were only approved because the City was providing second mortgage assistance to the homebuyers. The 1986 and 1987 issues are insured by FHA and backed by GNMAs.

The only issue which has witnessed significant foreclosure rates is the 1980 issue. The prevailing underwriting criteria in this issue, and in the industry, were significantly more liberal than in subsequent years. Moreover, the mortgage terms (12.25 percent for 12 years) became relatively unattractive as interest rates declined in the conventional market. Although the FHA-insured programs have loss loan history in the City's program, there is no indication of higher loan delinquency rates.

With this experience it is my firm belief that FHA insurance is the only insurance vehicle for first-time homebuyers and that its availability must track more

closely with the price levels in the respective housing markets. Thus, I and ALHFA strongly support the proposal to raise the FHA to 95 percent of area median sales price. Given the critical role of FHA and the restricted utility of pmi, I do not believe FHA insurance should be income-restricted. Such a restriction would subject FHA to some greater default risk, thereby necessitating more conservative underwriting.

I believe the widened applicability of FHA is more critical in expanding homeownership than the proposal to lower the downpayment requirement to 3 percent for the entire mortgage. With the price levels, prevailing in California, buyers will be required to put at least 5 percent down, even with FHA insurance, in order to qualify for loans.

Downpayments are critical obstacles for prospective first-time homebuyers, both in meeting minimum downpayment requirements and in reaching loan levels for which they can qualify, given incomes and outstanding debt. Therefore, legislation to permit use of IRAs and 401(k)s is highly desirable. However, younger families encounter the greatest difficulty in saving sufficiently to invest in IRAs or 401(k)s. Use of such instruments for downpayments may not have much substantive effect.

I believe the retirement account proposal could be broadened to provide incentives for employers to invest with employees in homes. Much of the increasing pressure on home prices comes from the population pressures occurring in growing regional economies such as Southern California. Lack of housing affordability may begin to have retarding economic impacts. Thus, a natural course may be to assist first-time homebuyers in partnership with employers. Perhaps IRA and 401(k) downpayment use could be permitted for relocating employees who are not first-time homebuyers, provided their employers provide supplemental downpayment assistance to employees who are first-time homebuyers. These employees are likely to have more substantial retirement accounts. Their use as downpayments may also save employers the cost of paying housing cost premiums. These savings could then be transferred as downpayment assistance for first-time homebuyers program.

Broadened availability of FHA insurance must be supplemented by other financing tools if homeownership is to be significantly increased. Mortgage Revenue Bonds, which have played an extensive role in providing vital financing assistance for first-time homebuyers during the past ten years, are one such tool. Individual savings and employer assistance incentives are additional tools that can be encouraged through the legislation under consideration by the committee.

22-940 O - 90 - 8

STATEMENT OF MR. ROBERT B. O'BRIEN, JR., CHAIRMAN
CARTERET SAVINGS BANK, NEWARK, NEW JERSEY

on behalf of the
UNITED STATES LEAGUE OF SAVINGS INSTITUTIONS

June 9, 1989

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

Mr. Chairman, my name is Bob O'Brien. I am the Chairman of Carteret Savings Bank of Newark, New Jersey. I am appearing on behalf of the United States League of Savings Institutions.* I also have the privilege of serving as the chairman of the League's Committee on Housing Policy. The League appreciates this opportunity to participate in the ongoing dialogue on housing policy begun by Senators Cranston and D'Amato over a year ago.

While the League has had the opportunity to comment on some of the issues raised here today in prior hearings, this is my first opportunity to do so. I would, therefore, like to take a moment to acquaint the Committee with my background in terms of the issues at hand and also describe briefly the current activities engaged in by Carteret Savings Bank. My career in the thrift industry and my involvement with affordable housing began in the mid-sixties when I worked for the Bowery Savings Bank in New York. The Bowery and the New York Bank for Savings jointly formed the Mutual Savings Bank Development Corporation for the purpose of financing the construction of new, affordable housing in Harlem and, eventually, other parts of the city. For three years, I served as the Chief Operating Officer of that corporation. Using the existing HUD programs of the day (235, 236, 221d3, etc.), we were able to build housing to be owned and operated by

* The U.S. League of Savings Institutions serves the more than 3,000 member institutions holding over $1.4 trillion in assets which make up the savings and loan bank businesses. The principal officers of the League are: Mr. Barney R. Beeksma, Chairman, Oak Harbor, Washington; Mr. Kenneth D. Seaton, Vice Chairman, Hancock, Michigan; and Mr. Frederick L. Webber, President, Washington, D.C. The League headquarters' office is located at 1709 New York Avenue, N.W., Washington, D.C. 20006. Telephone: (202) 637-8900.

nonprofit groups at favorable rates, housing which would not have been built under normal, market place arrangements.

In 1969 Federal Home Loan Bank Board Chairman Preston Martin appointed me to the post of Director of the FSLIC. When I assumed that position, I found that the insurance fund was holding $100 million worth of inner city housing as a result of foreclosures and thrift failures. We instituted a special loan program that was successful in getting most of the inventory into private ownership by low to moderate income families.

While serving as FSLIC director, I became involved in the establishing of the Office of Neighborhood Reinvestment. Its program of mobilizing private funds through thrifts to revitalize and preserve older neighborhoods was run by Mr. Bill Whiteside. As Chairman Cranston knows, that office of the Bank Board became a separate, Congressionally-chartered corporation ten years ago. I have continued to be active with its Neighborhood Housing Services' program which currently operates in 140 cities across the country, including my own city, Newark. Currently, I am serving as Chairman of Neighborhood Housing Services of America (NHSA), a secondary market vehicle which buys loans made by the participating thrifts and banks in the 140 cities with an NHS program. In 1978 I had the honor of being appointed by President Carter to a National Commission on Neighborhoods. I was one of two savings and loan executives to serve on the Commission.

I am sure that the Committee is aware of the fine work that has been done by Mr. Whiteside, his staff, and the hundreds of people who make the NHS program run smoothly. Among other things, I believe that the NHS program has provided clear evidence that the kind of public/private partnership that S. 565 and 566 call for can and will work. Indeed, this may be the best possible alternative means of getting the most out of the limited amount of available federal dollars for assisted housing.

Turning my attention to Carteret Savings Bank and its efforts in Newark and the state of New Jersey, our institution took the lead in setting up the New Jersey Urban Housing Partnership at the invitation of Governor Kean. The partnership has seven banks and and savings institutions which have pledged $125 million for loans for construction and major rehabilitation of housing in the urban centers of our state. While the program is only nine months old, I have great hopes that it will grow and will make a substantial improvement in the housing climate of New Jersey. Newark, in particular, but other of our urban areas as well, is one of the high cost

housing markets in the country where the first-time home buyer must often postpone that first purchase, not because of a shortgage of mortgage money, but because of the shortage of affordable houses.

Carteret itself is making an effort to bridge the affordability gap with a special loan program for low income families. Carteret has pledged to make $5 million in loans for home purchases to qualified borrowers who earn less than the area median income. We will make a 30-year, fixed rate loan at 1.5% below the market rate. We make the loan on a 5% down payment with no points or fees other than third party fees. In order to qualify borrowers in the program, we use slightly more lenient underwriting procedures than are the industry norm. Obviously, from what I have described, the loans made by Carteret in this program are not marketable to FNMA or FHLMC and are held by Carteret in its mortgage portfolio. While the program is only one year old, I am very happy to report that there has not been a single delinquency on any of the loans so far. As you might imagine, we monitor these loans very carefully, and there is more face-to-face counseling than in a traditional, conventional loan transaction. We are determined to make this program both successful and moderately profitable as well.

A General Comment on Affordable Housing

One of the worthwhile goals of the legislation before the Subcommittee is the renewed commitment of the Congress and the nation to home ownership. As the primary source of mortgage credit for home ownership in the nation, the thrift industry shares the objective as well as the overall goals of improving the housing conditions and living environments for all Americans.

While housing and housing costs in particular are complex issues, the affordability issue really boils down to one issue -- the cost of homes, the cost to build them, the cost to own, manage, maintain and finance housing. Most housing programs in the past have tended to focus on only one part of the equation, the cost of financing. When one looks at the history of our housing market over the past several years, the limited utility of this approach becomes clear. Mortgage interest rates are currently at the 10.5% level. They have been higher and they have been lower in recent memory. In fact, at the end of the disasterous experience of high interest rates in the early eighties, when rates started down, mortgage rates fell faster and farther than other interest rates.

While mortgage rates go up and down, housing prices generally go in one direction, UP. The cost of land, particularly in our urban centers and older suburbs where buildable land is scarce, has made building "moderate" priced homes almost impossible. The cost of building materials also have moved upward. If any assistance program in the area of affordability is going to be successful on a broad scale, it will have to address other aspects of the cost of housing in addition to finance.

Should The National FHA Loan Ceiling Be Eliminated?

Use of the FHA mortgage insurance program has always been limited by law. In 1979, the maximum mortgage loan ceiling for FHA loans was increased to $67,500 for single-family homes. In 1980, the FHA was given authority to increase these limits up to 133% for designated high cost areas.

In 1988, the FHA high cost limit was raised to 150% of the basic limit of $67,500. Thus, the maximum single-family FHA loan is now the lesser of 95% of an area's median home price or $101,250. It is now proposed that the 150% FHA loan ceiling be removed leaving the only limit on FHA loans to be the 95% of an area's median home price.

Removing the national FHA loan ceiling would not be good public policy for several reasons:

(1) Increasing Existing FHA Ceilings Would Primarily Benefit Upper Income Families.

Table 1 shows the median sale price of existing single-family homes in the second quarter of 1988 for five high-priced metropolitan areas, as reported by the National Association of Realtors. It also shows the new FHA limit as proposed, and an estimate for principal, interest, taxes and insurance. Using these estimates, the potential home buyer's required annual income to qualify for the loan is computed.

Obviously, the proposed elimination of the national maximum FHA loan limit would allow home buyers purchasing $200,000 homes to qualify for a direct federal guarantee of their loans. With a 20% down payment, home buyers purchasing $200,000 homes in each of the five metropolitan areas shown in Table 1 would be eligible for an FHA-insured mortgage loan.

More significantly, in order to qualify for these loans, the home buyers in these metropolitan areas would need annual incomes ranging between $80,000 and $94,000. The national median annual income in 1988 was estimated at $25,976, while

the median annual household income in these five cities ranged from $23,657 to $37,194. In other words, the home buyer qualifying for FHA-insured and, thus, federally subsidized loans would have roughly three times the national and metropolitan area median-income levels.

The fact is that those families having incomes of $80,000 or more do not need the federal government to guarantee their loans. Instead, they need the government's encouragement to save and, thus, build a substantial down payment to use to purchase a home. The FHA insurance program should not be used to subsidize upper income families.

TABLE 1

Without A National Ceiling, FHA Loans Would House High-Income Home Buyers

Metropolitan Area	Median Price	95% of Median	Taxes and Insurance[1]	Annual P & I[2]	Total Expense[3]	Qualifying Income
Orange County	$204,000	$193,800	$4,080	$22,147	$26,227	$93,669
San Francisco	196,300	186,485	3,926	21,311	25,237	90,133
New York	194,000	184,300	3,880	21,062	24,942	89,077
Boston	182,900	173,755	3,658	19,857	23,515	83,980
Los Angeles	175,600	166,820	3,512	19,064	22,576	80,629

1 Equivalent to 2% of the purchase price
2 Principal and interest on an 11%, 30-year loan
3 Assuming an expense-income ratio of 28%

(2) Increasing The FHA Ceilings Will Not Benefit First-Time Home Buyers But Instead Those Who Do Not Need Help.

The first-time home buyer does not buy the median-priced home. Instead, these home purchasers look for starter homes which tend to be older, smaller and lower priced than median-priced homes. Move-up buyers or repurchasers are the buyers of newer and larger homes. This is particularly true in high-cost housing areas.

Significantly, the fact that first-time home buyers purchase does not mean that these families are relegated to substandard housing. A recent (April 1989) Congressional Research Service (CRS) report on this issue states the following:

> Sub-median does not imply substandard. When a family purchases a home that is priced less than the area median, it does not imply that the family has purchased a substandard house. The FHA loan limit may be less than the median sales price in a community but many homes in the lower half of the price range may be both affordable and adequate for the home buyers traditionally served by FHA.

As a result, eliminating the current national ceiling of $101,250 will not help many first-time home buyers given the kinds of homes most can afford to buy. No low or moderate income first-time home buyer will be able to afford the monthly payments on a loan of $100,000 or more.

In this context, we also agree with the CRS study when it stated that:

> Many areas have an affordability problem - incomes have not kept pace with rising home prices. Raising the FHA limit, however, does not address the problem. If the family cannot afford the home, the level of the FHA limit does not matter.

Instead, the increase in FHA ceilings will provide new federal guarantees and the subsidies they involve to those who do not need help. Investors using FHA financing will benefit from the availability of larger loans. So will those who have already bought a home and want to refinance so they can benefit from the government's guarantee of their loan. Even those having substantial equity and looking to move up will find the much larger loan available a benefit.

In this regard, we believe that the FHA's performance could be greatly enhanced if it were properly targeted. For example, the Congress should consider eliminating FHA loans for investors. If we want to use the FHA program to help promote home ownership, such insured loans should be limited to owner/occupants.

Further, careful consideration should be given to limiting the program to first-time home buyers who need the low down payment benefits of an FHA loan. Direct federal guarantees should not be made available to those who simply want to refinance their mortgage loans. Nor should the federal government guarantee the loans of those who own a home and are potential repurchasers.

Most important, the income level of FHA borrowers should be limited to low and moderate income home buyers. Some have argued that FHA mortgages should be limited to those families having annual incomes not exceeding 125% of the median. This is not a bad idea and might even be applied on a regional or high-cost area basis.

(3) Eliminating The National FHA Ceiling Does Not Make Sense In Light Of The Recent Losses Of The FHA.

Clearly, the real financial condition of the FHA Fund should play a substantial role in the debate over whether this program should be expanded. Thus, two new GAO reports which examine the financial condition of the FHA deserve special attention. These reports review the FHA's accounting methods and provide the first outside audit of the FHA Fund ever.

What these reports suggest is that the FHA Fund not only lost money in fiscal 1987 and fiscal 1988, but that it continues to lose money right now. Normally, one would assume that seeing losses develop in the FHA program, the Congress would act to shore up its reserves and limit the federal government's exposure. One need only look at the losses incurred by the private mortgage insurance business in the 1980's to see what could happen to the FHA and the taxpayer.

Still, many people will argue that federal guarantees are a costless way for the government to assist in areas of need. Of course, both the Farm Credit System and the FSLIC crises prove that the idea that federal guarantees are costless is simply wrong.

One of the ways the FHA has hidden its losses has been to front load its income stream. In 1984, the FHA began collecting its entire insurance premium up front. Since loan defaults and foreclosures do not usually occur for two or three years after an FHA mortgage loan is made, this process accelerated income without recognizing future losses. These FHA premiums were not only collected on a cash basis but also taken into income immediately for accounting purposes.

This process is very similar to the technique used by a number of thrifts that have failed in recent years. These institutions took large loan fees up front and created funds to make the payments on a project for two or three years. Immediate profits were great, but there was no money available to cover the losses that they developed after a couple of years.

Both these thrifts and the FHA also were able to hide their increasing losses by growing fast enough so that their accelerated income from new loan premiums exceeded the losses on their older loans. Of course, this kind of Ponzi scheme runs out over time but, unfortunately, only after huge losses develop.

The FHA has also minimized its reported losses by delaying its recognition of claims. Private mortgage insurers (PMI's) using GAAP recognize and accrue losses on or about the time that defaults take place. This is based upon the notion that default is the earliest measurable indicator that the company has incurred a loss.

In its report, the GAO notes that the FHA usually recognizes losses at the date of foreclosure. This tends to delay FHA loss recognition up to one year longer than is standard for PMI's. Correcting this situation was one of the many adjustments made to the FHA's financials in its 1987 audit.

This whole picture of accelerating income and deferring losses at the FHA is all the more troubling when one recognizes that Price Waterhouse, at the request of the GAO, just completed the first ever audit of the FHA. The fact that we just now are seeing the results of the fiscal 1987 audit can only raise concerns about what may be found in the fiscal 1988 audit to be released later this year. Already, the GAO is reporting that the FHA Fund, not only had losses in 1987 and 1988, but will also report a loss for fiscal 1989.

On the positive side, the FHA has now been placed on a GAAP reporting basis. Prior to its 1987 GAAP audit, the FHA had reported $3.1 billion of equity. After over 60 audit adjustments to the agency's books, the FHA now reports equity of $1.2 billion at the end of fiscal 1987. Moving to GAAP for reporting purposes means that the Congress and the taxpayer will now receive a more accurate reflection of the real financial condition of the FHA.

The fact that the FHA has been and will continue to lose money is in itself reason for concern. This is all the more troubling, given the fact that the most recent reliable data on the FHA dates back to September 1987.

Another aspect of this report on the FHA could be worrisome. The report notes that HUD hired an independent contractor who concluded that as of December 31, 1987, "...the Fund was in sound financial condition based upon historical trends and their assessment of probable future events. Based on the results of an economic stress test, the independent

contractor further indicated that the Fund (1) would barely survive under more severe regional stress and (2) would not survive under national stress without U.S. Treasury support." Many taxpayers may not find this too reassuring.

Finally, probably the greatest reason for public concern about the FHA Fund relates to its reserve ratio. Private mortgage insurers are generally required to maintain an insurance-in-force to capital ratio of 25 to 1. As of September 30, 1987, the FHA reported net worth of $1.2 billion and insurance-in-force of $277 billion for a ratio of 252 to 1. For that matter, given additional losses expected in 1988 and 1989, the real reserves of the FHA Fund may already be negative at this point in time.

Common sense would suggest that the growing losses of the FHA Fund would lead public policy makers to act to limit the federal government's future exposure while requiring that the Fund's reserves be increased. Even with the recent losses created for the FSLIC by thrifts that attempted to grow out of their problems, there will be those who argue that the FHA should grow out of its financial difficulties.

The idea is that larger mortgage loans can be used to subsidize smaller FHA loans. This assumes that such larger loans will have a lower default rate, but pay the same FHA insurance rates as are paid on smaller loans.

Of course, this cross-subsidization idea assumes that it is efficient for the government to subsidize higher income borrowers who do not need such subsidies so that the fees they pay will cover the losses created by other borrowers. Even if this idea worked, it would be highly inefficient and inequitable. The real cost of these subsidies would be borne by all other non-subsidized credit users in the market place. Further, the cost to those bearing the burden would increase as the number of subsidized borrowers increases.

Even ignoring this somewhat academic "efficient subsidy" debate, however, the fact is that large mortgage loans with small down payments and liberal underwriting standards are not necessarily safer than similar smaller mortgage loans. They may appear to be safer in current FHA programs. This results from the fact that some wealthy borrowers take advantage of the FHA subsidies by making very large down payments so they can get low cost loans under the FHA loan limits.

To the extent that larger FHA loans serve first-time home buyers with moderate incomes, we should not expect them to have significantly lower default rates. If raising or removing the

FHA mortgage loan size limits allows more wealthy borrowers access to federal subsidies, however, FHA default rates would probably be reduced. Such an objective -- increasing the number of wealthy FHA borrowers -- however, is questionable public policy.

The FHA still has a useful role to play in residential mortgage finance. First-time home buyers face major barriers to home ownership. It is clearly reasonable for the government to help lower the down payment problems of low and moderate income first-time home buyers so they can realize the dream of owning a home of their own.

Federal mortgage loan guarantees, however, expose the taxpayer to a real risk of loss. The solution is not to expand the federal guarantee process so that every home buyer, no matter how great his income or wealth, can receive a subsidized mortgage loan. Instead, federal mortgage guarantees should be targeted so that only those in real need benefit. At the same time, the FHA Mutual Mortgage Insurance Fund should be restructured to achieve financial integrity.

Addressing the Down Payment Issue in the Tax Code

Research recently conducted by the U.S. League on home ownership which segmented the home buyer population into first-time buyers and repurchasers indicates that a major barrier for the first-time buyer is the down payment. There are many families that do qualify for mortgage loans in terms of income to debt ratios and monthly payments, etc., but who do not have sufficient funds for a down payment.

Ideally, personal savings should be the primary source of down payment funds. This was the case in years past and would be again, except for one thing: the price of homes rises faster than many families can realistically build their savings. For people of low and moderate income, the solution has to be found in a direct assistance program, such as the HUD 235 or a subsidized second trust. Another solution is the low down payment FHA loan option for first-time buyers in the Cranston-D'Amato bills.

For families above the median income level where direct federal government assistance would be unwarranted, there is a solution also to be found in the legislation before us. I am referring to the provisions permitting the use of IRA and 401(k) saving for home ownership. The U.S. League has long advocated this type of federal tax policy and is pleased to see that the sponsors of the legislation kept this concept alive in

the process. We are well aware of the resistance to this and other homeownership plans by the "tax experts" who see these proposals as "raids" on retirement savings.

The U.S. League will continue to press the case for these measures with the tax writing committee of Congress. The most important part of that case is that home ownership is a very important part of a family's financial planning for retirement. In fact, it is hard to imagine a more important ingredient in financial security than entering one's retirement years owning one's home free and clear. Absent that condition, the retiree is faced with the prospect of paying escalating rents out of their retirement income. If home ownership is a part of the retirement plan early on, then retirement income will provide a much higher standard of living.

While the U.S. League is pleased to see the inclusion of the IRA and 401(k) provisions of the bill, we must also suggest that the provisions as drafted are unnecessarily complex. In fact, we are concerned that the restrictions placed on the use of the accounts and the other provisions may actually discourage people from taking advantage of the opportunity intended by the bill. We suggest that all that is needed is to amend the tax code to provide that the use of accumulated funds in either of these types of accounts for the down payment on a first home (principal residence only) will be treated as a penalty free withdrawal. The ordinary tax obligation would apply, but not the penalty. In this way, the actual cost to the Treasury of the proposal would be negligible, if any. Granted, the amount available for the down payment would be reduced by the amount of the tax liability at the time, but we believe that this would be preferable to the rather cumbersome requirements presently contained in the bill.

There is also a larger social and economic benefit to this proposal. By allowing the use of retirement account funds for home purchase, there will be a much greater chance of people opening these accounts earlier in their income-producing years. Our experience with retirement savings accounts is that they are opened and contributed to regularly by people age 40 and over, in most cases by people who are already home owners. Our proposal would give wage earners a positive incentive to begin regular savings at an early age. This would result in an automatic increase in the overall savings rate in the economy, answering a problem our economists have been warning us about for some time -- the very low savings rate in our society. The increased savings that would come from this plan should be reflected in greater availability of capital in the economy which in turn will have a downward pressure on interest rates in general.

The social benefits to be derived from the proposal are not as immediate but are just as important. For one thing, there would be a renewed upward trend in the home ownership rate. That rate rose steadily from the mid-1940s to 1980 and then declined. While that decline has been modest, just the fact that it is falling at all means that thousands of families each year are missing the opportunity to become home owners.

The second social benefit to be achieved is the higher degree of individual self-reliance for income security after retirement and the corresponding lessening of political pressure to provide that security through the Social Security Trust Fund. For all these reasons, we would urge the authors of the legislation to adopt the simpler and more direct method of encouraging the use of retirement accounts for down payment purposes.

General Comments on the Delivery of Housing Assistance

There will no doubt be other witnesses better qualified to assess the strengths and weaknesses of the new federal-state-private sector relationships called for by the legislation. In general, however, the approach is one we would favor. While the housing problems are national in scope and the resources, in large part, must be gathered at the national level the building of homes, the rehabilitation of homes, the restoration of neighborhoods are inherently local in nature. The federal government can set standards and allocate the scarce resources broadly, but the work has to be be done street-by-street and community-by-community. For this reason, we believe that the HOP design of the bill is appropriate and should be implemented as the delivery vehicle for federal assistance.

With respect to the creation of new offices and titles within the Department of Housing and Urban Development, we would offer the suggestion that for every new agency or office created, at least one, if not two, should be abolished. HUD exists to deliver housing, not to perpetuate HUD. Having said that, we do want to endorse the idea that special attention given to the unique needs of the elderly, handicapped and the homeless. These areas of need are sufficiently unique to call for special attention and innovative ideas. The idea of an Office of Supportive Housing is a proper step to giving these areas the special attention they must have.

Conclusion

In conclusion, Mr. Chairman, the U S. League appreciates this opportunity to comment on the National Affordable Housing Act and to participate in the dialogue with others who share our commitment to home ownership in America. We look forward to working with the Subcommittee in the weeks ahead to secure passage of legislation which will advance our common objectives.

STATEMENT OF

THE HONORABLE DEAN WEATHERLY

BOARD OF SUPERVISORS

PINAL COUNTY, ARIZONIA

FRIDAY, JUNE 9, 1989

ON

S.565 AND S.566

THE NATIONAL AFFORDABLE HOUSING ACT

BEFORE

SENATE SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

101ST CONGRESS, 1ST SESSION

CONCERNING REFINEMENTS TO TITLE II HOMEOWNERSHIP,

SUBTITLE A - FHA AMENDMENTS

MR. CHAIRMAN, IT IS A PRIVILEGE TO APPEAR BEFORE YOU TODAY TO TESTIFY CONCERNING REFINEMENTS TO SUBTITLE A - FHA AMENDMENTS UNDER TITLE II - HOMEOWNERSHIP, OF THE NATIONAL AFFORDABLE HOUSING ACT. I AM A MEMBER OF THE PINAL COUNTY BOARD OF SUPERVISORS.

HOMEBUYERS ARE HAVING DIFFICULTY BUYING FHA INSURED HOUSING. THE PROPOSED INCREASE IN THE FHA CEILING WILL OBVIOUSLY HELP, BUT THE METHOD OF ARRIVING AT THOSE LIMITS IS VERY KEY TO PLACING OUR AREA IN PROPER RELATIONSHIP TO ADJOUNING AND NEARBY HOUSING MARKETS.

IT IS IMPORTANT TO NOTE THAT PINAL COUNTY IS A LARGE COUNTY, GEOGRAPHICALLY. BY COMPARISON WITH MOST COUNTIES IN THIS COUNTRY, OUR BOUNDARIES CONTAIN 5,384 SQUARE MILES OF LAND - WE ARE AS LARGE AS 5 OR 6 EASTERN COUNTIES COMBINED. WE COULD CONTAIN ALL OF THE STATE OF DELAWARE, ALL OF THE STATE OF RHODE ISLAND AND HALF OF THE STATE OF CONNECTICUT WITHIN OUR BOUNDARIES.

OUR HISTORY EMBRACES AGRICULTURE AND MINING IN THE SONORAN DESERT. BUT DURING THE LAST DECADE WE HAVE BEGUN TO URBANIZE; PARTICULARLY IN OUR TWO LARGER CITIES, CASA GRANDE, (POPULATION EST. AT 20,000) AND APACHE JUNCTION, (POPULATION EST. AT 17,000). CASA GRANDE IS IN A GROWTH CORRIDOR AT THE INTERSECTION OF INTERSTATE HIGHWAY 10 AND INTERSTATE HIGHWAY 8. THIS IS LESS THAN AN HOUR'S DRIVE FROM PHOENIX OR TUCSON. APACHE JUNCTION HAS BECOME AN EXTENSION OF THE PHOENIX METROPOLITAN AREA. NEITHER OF OUR COUNTY'S TWO PRINCIPAL CITIES ARE IN THE PHOENIX MSA. LOAN LIMITS IN PHOENIX AND TUCSON ARE AT LEAST 30% HIGHER. THEIR HIGHER LOAN LIMITS CREATE BARRIERS TO FAIR HOUSING IN OUR AREA.

OUR LARGE COUNTY HAS SOME DEPRESSED MINING AREAS. THESE ARE LOCATED ALMOST A HUNDRED MILES AWAY. THESE AREAS DRIVE DOWN OUR MEDIAN SALE PRICE AND CREATES A LIMIT FAR TOO LOW FOR THE NEEDS OF OUR TWO PRINCIPAL COMMUNITIES.

THUS, OUR COUNTY'S LOAN INSURANCE LIMIT IS $69,350. ON BOTH SIDES OF US, IN THE PHOENIX AND TUCSON MSA'S, THE NEW LOAN INSURANCE LIMIT IS $101,250.

WE HAVE MADE THREE SEPARATE EFFORTS AT RAISING OUR LIMITS IN THE PAST TWO YEARS. DOZENS OF LETTERS AND RESOLUTIONS BY LOCAL GOVERNMENTS, COMMUNITY AND INDUSTRIAL LEADERS HAVE DEMONSTRATED OUR NEED TO BE MORE COMPETITIVE. I HAVE INCLUDED SOME OF THE DOCUMENTATION WITH THESE COMMENTS.

AS A RESULT OF HIGHER FHA CEILINGS IN THE METROPOLITAN AREAS, OUR COMMUNITIES' NEW INDUSTRIAL MANAGERS ARE BUYING HOUSING IN THE PHOENIX, CHANDLER, MESA, TEMPE, AND GILBERT AREAS.

IN APACHE JUNCTION, A SECTION LINE STREET IS THE BOUNDARY BETWEEN MARICOPA AND PINAL COUNTIES. THE CITIES OF MESA AND APACHE JUNCTION SHARE CITY LIMITS IN THE MIDDLE OF THAT STREET. MESA'S LOAN INSURANCE LIMIT IS $31,900 LARGER.

THE VA LOAN MAXIMUM OF $110,000, WITH NO DOWN PAYMENT HELPS TO A SMALL DEGREE. BUT, FOR CONVENTIONAL LOANS, THE NORMAL MINIMUM DOWN PAYMENT IS TEN PERCENT. IN ADDITION, AS A RESULT OF DEREGULATION, OUR SAVINGS AND LOAN INSTITUTIONS APPEAR MORE INTERESTED IN SPECULATIVE LOANS FOR SUCH THINGS AS RAW LAND THAN IN MAKING HOME LOANS.

CONSEQUENTLY, A QUALIFIED HOME PURCHASER ATTEMPTING TO PURCHASE AN $85,000 HOUSE WITH FHA INSURANCE IN PINAL COUNTY MUST MAKE A DOWN PAYMENT OF $15,600. THE SAME BUYER CAN PURCHASE A SIMILARLY PRICED HOME IN MARICOPA COUNTY 45 MILES AWAY WITH A $2,350 DOWN PAYMENT.

THE GAP WIDENS ON A $100,000 HOME. HOMEBUYERS IN PINAL COUNTY REQUIRE A $20,650 DOWN PAYMENT. FOR THE SAME FHA INSURED HOME IN OUR NEIGHBORING COUNTIES OF PIMA AND MARICOPA, THE DOWN PAYMENT IS $4,600.

IN PRACTICALITY, THESE EXAMPLES MAKE A GOOD CASE FOR DE FACTO RED LINING. THESE MODESTLY PRICED HOMES BECOME UNAVAILABLE TO THE AVERAGE BUYER WANTING TO BUY IN OUR TWO COMMUNITIES.

UNDER PRESENT RULES, ONLY COUNTY SIZE AREAS OR LARGER ARE CONSIDERED TERRITORIAL JURISDICTIONS. BECAUSE OF THE WIDE DISPARITY IN MEDIAN SALE PRICES WITHIN OUR GEOGRAPHICALLY DISPERSED COUNTY, THE PRESENT MEDIAN SALES PRICE LUMPS THE CITIES OF CASA GRANDE AND APACHE JUNCTION WITH THE MINING AREA WHERE HOME VALUES ARE SUBSTANTIALLY LESS. UNDER S.565, HUD WOULD HAVE AUTHORITY TO ESTABLISH MEDIAN SALES PRICES IN SMALLER THAT COUNTY SIZE AREAS. WE HOPE THIS MEANS HUD WOULD ALLOW MEDIAN PRICES IN CASA GRANDE AND APACHE JUNCTION TO BE BASED ON ACTUAL MARKET CONDITIONS WITHIN THOSE DISTINCT COMMUNITY.

WE PROPOSE THAT S. 565 EXPAND THE LOAN LIMITS AT THE UPPER LEVEL OF HOME SALES PRICES IN COMMUNITIES THAT ARE OUTSIDE AN MSA UPON SHOWING THAT PRICES IN THOSE COMMUNITIES ARE DIRECTLY AFFECTED BY PRICES WITHIN THE BORDERING MSA.

FAIR HOUSING SHOULD BE AVAILABLE IN ALL MARKETS. WHILE NEEDS IN MAJOR METROPOLITAN AREAS MAY BE MORE DEMANDING THAN THOSE OF OUTLYING "LOW COST AREAS", REGULATORY AND EVALUATIVE SYSTEMS SHOULD NEVER BE BARRIERS TO THESE COMMUNITIES WISHING TO TAP THEIR GROWTH POTENTIAL. A MORE FLEXIBLE METHOD SHOULD BE MADE TO WORK FOR ALL COMMUNITIES.

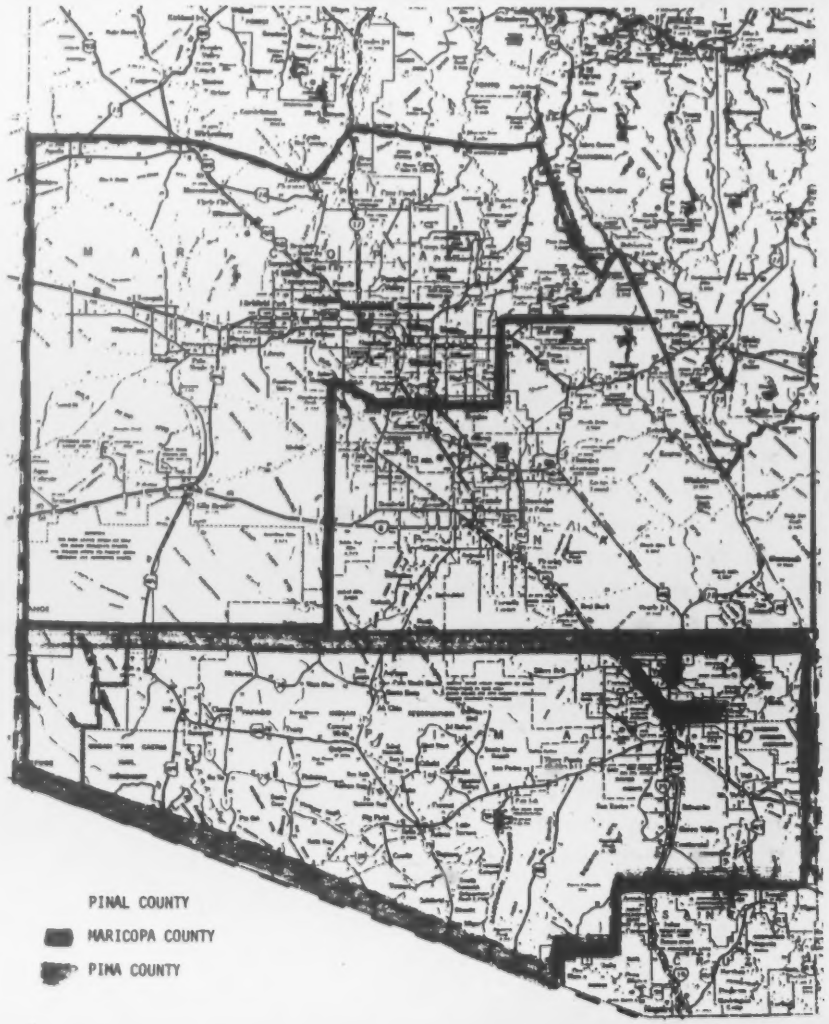
THE STRINGENT LOAN INSURANCE LIMITS CURRENTLY PLACED ON OUR COMMUNITIES, MAKE IT MORE DIFFICULT TO ATTRACT HOME BUILDERS BECAUSE THEY KNOW THEY MUST BE ABLE TO ATTRACT MORE THAN A NARROW SEGMENT OF THE MARKET - OR FACE ABSORPTION RATES THAT SPIRAL DOWNWARD.

OUR CITIZENS SHOULD NOT BE FORCED TO LIVE OUTSIDE THE COMMUNITY WHERE THEIR JOBS ARE LOCATED TO FIND AN EQUAL LENDING OPPORTUNITY. BUILDERS SHOULD BE ABLE TO EXPECT "EQUAL FINANCING" TO MARKET THEIR PRODUCT.

OUR COUNTY BOARD OF SUPERVISORS AND OUR TWO CITY COUNCILS ENDORSE THIS EFFORT YOU HAVE LAUNCHED TO MAKE AFFORDABLE HOUSING AND INCREASED HOMEOWNERSHIP ACHIEVABLE.

WE WILL BE PLEASED TO SUPPLY ANY ADDITIONAL INFORMATION YOU MIGHT REQUEST.

THANK YOU!



IAN WEATHERLY, Chairman
Casa Grande

ALS J. GABAM, JR., Member
Superior

"BILL" MATHESON, Member
Mammoth

QUENTIN D. BICHEL
Clerk
Assistant Administrator

JAY BATEMAN
Administrator

PINAL COUNTY

Board of Supervisors

P.O. BOX 827 - FLORENCE, ARIZONA 85232
TELEPHONE (602) 868-5801
Facsimile (602) 868-6765

RESOLUTION 32188-PC-FHA

WHEREAS, the U.S. Department of Housing and Urban Development has established the maximum FHA loan amount for Pinal County at $69,350.00, and,

WHEREAS, housing costs and the cost of land for subdivisions continues to rapidly increase, and,

WHEREAS, the median sales price of a home in many parts of Pinal County exceed $80,000, and,

WHEREAS, the federal government has recently raised FHA maximum loan limits in the metropolitan areas of Maricopa County and the Pima County/Tucson area to exceed $100,000, and,

WHEREAS, much of the growth in Pinal County is a spill-over effect of the metropolitan areas, and,

WHEREAS, research in Pinal County indicates that increasing numbers of executive employees attracted by new industry are locating in the metropolitan areas instead of adjacent to plants they are operating in Pinal County, and,

WHEREAS, this is being construed by some as reverse discrimination in relation to equal housing opportunity,

BE IT NOW THEREFORE RESOLVED that the Pinal County Board of Supervisors, in Continued Regular Session this date respectfully requests the support of our duly elected Federal Representatives and the U.S. Department of Housing and Urban Development to quickly affect the necessary steps to provide relief from these unduly harsh and discriminatory loan limitations.

DONE this 21st day of March, 1988.

PINAL COUNTY BOARD OF SUPERVISORS

Ian Weatherly, Chairman

James J. Abram, Jr., Member

Wm. "Bill" Matheson, Member

ATTEST:

Quentin D. Bichel, Acting Clerk

CITY OF CASA GRANDE

F.B. KERR, Mayor
ER L. BENNETT, City Manager

March 9, 1988

Ms. Debbie Yost
Realty Executives
1135 East Florence Boulevard
Casa Grande, AZ 85222

Dear Debbie:

Thank you very much for your letter of yesterday, March 7, 1988. It clearly outlines our conversation of the other day during which we discussed the surprisingly low Federal Housing Authority maximum loan limits in Pinal County. I agree with you--I cannot understand why Pinal County limits should be so drastically different from Pima or Maricopa Counties.

It is very clear that Casa Grande is a rapidly changing community with an upgraded housing demand. We are located in an area whose economy is changing rapidly due to our very favorable location and productive labor force. The immigration of people in all economic strata is obvious. We are able to fill our existing housing inventory and are still sending upper income people to the suburbs of Maricopa County for a variety of reasons, not the least of which is the fact that adequate financing cannot be obtained for higher sales priced dwellings. It certainly seems unrealistic and unfair for FHA loan limits to be more than $18 lower than Maricopa and Pima Counties.

Because of our rapid economic development and our competitive commuting times, we are effectively in the same housing market with Maricopa County. The average cost of housing in many cases is slightly more expensive in Casa Grande than in the southern regions of Phoenix, Tempe, and Chandler. Raw land costs prior to development are approximately the same as in suburbanizing Maricopa County. Yet, land development costs including the extension of utilities tend to be higher here than in metro areas. The fact is, in short, housing costs are equal or slightly higher in Casa Grande than in Maricopa County. It is also a fact that we have a pent-up housing demand for medium to upper priced homes that is being restricted because of artificially low FHA loan limits.

223

Ms. Debbie Yost
Realty Executives
Page 2
March 9, 1988

I encourage you to actively pursue higher FHA loan limits for Casa Grande. It is my belief that we are deserving of loan limits that are not less than 4% less than those of Maricopa and Pima County.

You are certainly free to use this letter in your meeting with Federal Housing Administration officials. Please do not hesitate to contact me or Rick Collins, our Planning and Development Director, with any questions that you may have. Thanks for your help on behalf of our community.

Sincerely,

Rodger L. Bennett
City Manager

RLB:cl

cc: Richard W. Collins,
Planning and Development Director

RESOLUTION NO. 1746

A RESOLUTION OF THE MAYOR AND CITY COUNCIL OF THE CITY OF CASA GRANDE SUPPORTING LEGISLATION TO INCREASE THE FHA MAXIMUM LOAN LIMITS.

WHEREAS, FHA loans are a critical element in the provision of adequate housing, and

WHEREAS inflation and land values have in many cases rendered existing limits obsolete, and

WHEREAS current law unfairly encourages growth in some areas at the expense of others, and

WHEREAS it has come to the attention of the City of Casa Grande that legislation is being introduced in the United States Senate to address these problems,

BE IT RESOLVED BY THE COUNCIL OF THE CITY OF CASA GRANDE, ARIZONA, as follows:

That the Mayor and Council of the City of Casa Grande support any legislation that will increase the utility of FHA loans in the City of Casa Grande and it is further resolved that any such legislation should contain the following features:

1. Eliminate the current ceiling of $101,250 and allow the loan limit to be 95% of the median sales price.

2. Raise the loan floor for rapidly growing rural areas such as Pinal County to $101,250 or 95% of the median sales price for housing for the area - whichever is higher.

3. Reduce the jurisdictional area in which the 95% formula applies to an incorporated city limit to allow cities like Casa Grande to submit valid city sales data which justifies the increase.

PASSED AND ADOPTED by the Mayor and Council of the City of Casa Grande, Arizona, this 6th day of February, 1989.

Mayor

ATTEST:

City Clerk

APPROVED AS TO FORM:

City Attorney

22-940 O - 90 - 9

RESOLUTION NO. 89-07

A RESOLUTION OF THE MAYOR AND CITY COUNCIL OF THE CITY OF APACHE JUNCTION, ARIZONA, SUPPORTING LEGISLATION TO INCREASE THE FHA MAXIMUM LOAN LIMITS, THEREBY PROVIDING ACCESS FOR MORE CITIZENS TO AFFORDABLE HOUSING.

WHEREAS the City of Apache Junction in Pinal County, Arizona, wishes to encourage home ownership with reasonable and comparable mortgage loans, and,

WHEREAS Apache Junction is by geographic proximity and normal economic activity a part of the Phoenix Standard Metropolitan Area and Southeast Maricopa County housing market, and,

WHEREAS the economic linkages between Apache Junction, and the East Valley financial and real estate network; the housing markets of Mesa, Gilbert, Chandler, Tempe and environs are apparent and pertinent, and,

WHEREAS Apache Junction home buyers are at a disadvantage in obtaining FHA mortgage loans under loan limitations set by the Federal Housing Act, and,

WHEREAS the inability to finance home ownership via FHA mortgage loans at maximum amounts comparable to area market conditions is an obstacle to the growth and development of City of Apache Junction,

THEREFORE, BE IT RESOLVED, that the Mayor and Council of the City of Apache Junction, Arizona support legislation that will increase utilization of FHA mortgage loans within the City of Apache Junction and its environs by:

1) Amending the Federal Housing Act to provide an alternative method to set the maximum FHA mortgage loan limit by local market area annual home sales when a city or community is located within the economic impact of a standard metropolitan area and/or encompasses more than one county or state entity.

2) Eliminating the current ceiling of $101,250 and allowing the loan limit to be 95% of the median sales price within the market area.

3) Raising the loan floor for rapidly growing rural areas to $101,250 or 95% of the median sales price for the market area - whichever is higher.

4) Adjusting the jurisdictional area in which the 95% formula applies to define a market area for which valid sales data can be provided.

BE IT FURTHER RESOLVED that this resolution be forwarded to President Bush, and appropriate Cabinet members; the Arizona Congressional

delegation; members of the House Banking Committee and Senate Banking Committee; the FHA Director and Arizona FHA Administrator; Pinal County Board of Supervisors; the National Board of Realtors and others with an akin interest, with a letter from the Mayor requesting assistance in this matter.

BE IT RESOLVED by the Mayor and City Council of the City of Apache Junction, Arizona, this 7th day of March, 1989.

SIGNED AND ATTESTED TO THIS 9TH DAY OF MARCH, 1989.

NORMAN S. HILL
MAYOR
by Vice Mayor Tom DAmiano

Attest:

Kathleen Connelly
City Clerk

Approved as to form

David F. Alexander
City Attorney

Casa Grande Board of Realtors

550 E. Cottonwood Lane • Casa Grande, Arizona 85222

March 7, 1988

Mr. Dwight Peterson
Federal Housing Administration
Phoenix, Arizona

Dear Mr. Peterson:

The present Federal Housing Authority (FHA) maximum loan in Pinal County is $69,350. At the first of 1988 we were under the impression that an approval of an increase to $76,000 from Housing and Urban Development (HUD) of Washington D.C. was forthcoming. For some unknown reason, Pinal County's increase was not included in the recent announcement in which Maricopa County and Pima County were boosted from $90,000 to $101,250. Coconino County maximum loan amount is $80,750. All remaining Arizona counties have a limit of $67,500.

On October 1, 1987 a list of 144 home sales in Casa Grande between October 1, 1986 and October 1, 1987 was submitted to FHA showing a median sales price of $80,000. We are currently compiling sales data from October 1, 1987 to the present that will indicate an even higher median sales price.

A prospective buyer in Pinal County who needs FHA financing can purchase a $70,000 home with approximately $4,000. This amount of money will cover the down payment and closing costs. If the same prospective buyer were to select an $80,000 home, he would be forced to produce $10,500 for a conventional loan down payment and closing costs or $12,500 for an FHA down payment and closing costs at our present $67,350 limit. If our hypothetical home buyer were to purchase an $80,000 home with the FHA limit increased to the median price of $80,000, he would need only $4,500 for down payment and closing costs.

Casa Grande is no longer a totally rural community. We have many major manufacturers, including Meredith/Burda, Ross Laboratories and Frito-Lay. Executives being transferred to Casa Grande have not been able to purchase the caliber of home they are accustomed to because adequate FHA financing is not available. These potential home purchasers have been forced to purchase a home of considerably less value than they intended or they purchase outside of Pinal County.

It is possible that the lack of reasonable FHA loan limits has affected the availability of young executive homes. This is a deterent to companies that might be considering Casa Grande as a possible location.

It would benefit all of Arizona if the home buyer's loan limit in Casa Grande and Pinal County were more inviting. An FHA maximum loan amount of at least $80,000 would definitely improve the housing market.

Sincerely,

Frank Barancik, President

Debbie Yost, President Elect

Robb Lauhon, Vice President

Doria Baeza, Secretary

Joe Yost, Treasurer

Director

Director

Director

Director

Director

Director

226

ROSS LABORATORIES CASA GRANDE, ARIZONA 85222
DIVISION OF ABBOTT LABORATORIES, U.S.A.

March 9, 1988

Ms. Debbie Yost
REALTY EXECUTIVES OF CASA GRANDE
1135 East Florence Blvd.
Casa Grande, AZ 85222

Dear Debbie:

As you know, we are currently expanding our facility and are looking for more growth in the future. Recuiting the best possible candidates for positions we have in our operation is one of our top priorities. It has been our history in the plant that either new employees or transferred employees from other Ross sites have had to pay 10-20% more for comparable housing in the Casa Grande area than in their previous locations.

You can see how important it is to have all avenues of finance available for them, including an adequate finance limit for FHA loans. Currently, the limit allowable within the state does not meet the needs of our employees and the difference will continue to grow if action is not taken to increase this limit.

I appreciate the action you are taking to help correct this problem and if I can be of help, please do not hesitate to contact me.

Sincerely,

Dennis K. Janiak
Plant Manager

DKJ-88-022
DJK:nb:0759A

March 7, 1988

Dwight Peterson
Federal Housing Administration
Phoenix, Arizona

Dear Mr. Peterson:

Hexcel is the largest employer in the Casa Grande area. Our employees, both existing and relocating, constantly comment on the lack of adequate government insured financing for housing in Pinal County.

Although their salary levels are adequate to obtain conventional financing, most employees do not have the cash reserves necessary to purchase a home in the desired price range with the current $69,350 FHA loan limit.

As a result, many of our employees have purchased homes in Maricopa County and commute to our plant in Casa Grande. These employees comment that housing values in Pinal County and Maricopa County are comparable for like homes in similar locations.

We ask you to increase the FHA maximum loan amount for Pinal County to an increased amount which will more accurately reflect the housing market in our area.

Sincerely,

Alex Montoya
Human Resources Manager

jab

122

Meredith/Burda

1145 W Gila Bend Hwy
Box C-8
Casa Grande, AZ 85222
602-836-2200

March 4, 1988

Mr. Dwight Petterson
Federal Housing Administration
Phoenix, AZ

Dear Mr. Petterson:

This letter is to address the detrimental impact we are currently facing as a result of costs of living in Casa Grande.

The current ceiling level of $69,350 is unrealistic for this area. Many of our personnel whom we attempt to transfer or hire from our other locations continually comment that comparable housing is approximately one and one-half times more expensive than in their locales.

This has proven to create a burden for reasonable mortgage rates on transfers, who have rejected offers because they cannot afford the relocation expense associated with housing. Reasonable, affordable rates for housing is paramount for us to maintain a viable work force, and continue our growth.

We urge you to consider increasing the current FHA ceiling, feeling that such action will allow continued economic growth for businesses and the community-at-large.

Thank you for your consideration.

Sincerely,

Norman R. Poole
Manager, Employee Relations

NRP/kc

THE Arizona BANK

March 9, 1988

Federal Housing Authority
ATTN: Mr. Dwight Peterson

RE: Pinal County Maximum Loan Limit

Dear Mr. Peterson:

We were dismayed to learn that Pinal County was not included in the recent announcement that maximum loan limits for FHA loans were increased.

Casa Grande's economic diversification has attracted several new industries. With those new industries, executives have been transferred to the area. Many of these people are looking for custom homes which fall into the conventional mortgage category due to sales prices of $75,000.00 plus. Several families have opted to purchase homes in South Maricopa County and commute, primarily due to availability of FHA financing on this type of home. This is a detriment to Casa Grande and Pinal County.

In view of Casa Grande's geographical location between Maricopa and Pima counties, we feel it is imperative for Pinal County to have the ability to compete in the housing market with an increased maximum limit of $80,000.00 for FHA financing.

Sincerely,

Sharon A. Cranford
Asst. Vice President &
Manager Casa Grande Office

Robert R. Wheeler
Asst. Vice President &
Manager Casa Grande East Office

228

Valley National Bank of Arizona
CASA GRANDE OFFICE
P.O. BOX 999
CASA GRANDE, ARIZONA 85222

March 8, 1988

Mr. Dwight Peterson
Phoenix Area FHA Office Manager

RE: FHA MORTGAGE LIMIT INCREASE
RECOMMENDATION FOR CASA GRANDE.

Dear Mr. Peterson:

As you may or may not be aware, our community of Casa Grande has been enjoying a period of industrial growth for the last few years. Examples of industries locating manufacturing plants here recently are : Ross Abbott Laboratories with 300 employees; Frito-Lay Corporation with 200 employees; Meredith-Burda with 300 employees; plus other industries. We are also expecting additional industries to locate here in the future and anticipate continued growth as our community further diversifies

When the aforementioned companies were locating here, one of the concerns most frequently heard from their people was the lack of housing available to the middle management and higher employees.

Along with this, the biggest percentage of the employees hired by these new industries were local people who increased their annual wages considerably.

It is also well to note that housing costs in Casa Grande are almost identical to the Phoenix and Tucson metropolitan areas.

To summarize, with the recent and expected future growth of Casa Grande and the cost of homes already in the same price ranges of Phoenix and Tucson, it would certainly be beneficial if the FHA mortgage limit were to be increased.

Sincerely,

James G. Marsh

Vice President/Manager

JAMES G. MARSH
gjj

Statement of

David W. Balcer
Senior Vice President
First Financial Bank
Milwaukee, Wisconsin

on behalf of
the National Council of Savings Institutions

before the
Subcommittee on
Housing and Urban Development
of the
Committee on Banking, Housing and Urban Affairs
of the
United States Senate

on
"Homeownership Affordability"

June 9, 1989
10:00 a.m., Room SD-538, Dirksen Senate Office Building

Mr. Chairman, members of the Subcommittee, my name is David W. Balcer. I am Senior Vice President with First Financial Bank, FSB, a federally chartered, FSLIC-insured stock institution in Milwaukee, Wisconsin, with over $2.3 billion in assets. I am testifying today in my capacity as a member of the Mortgage Finance Committee of the National Council of Savings Institutions. The National Council is a trade association representing savings banks and savings and loan associations in 37 states. Its 500 members hold approximately $550 billion in assets, about 35 percent of the industry's total assets.

The National Council of Savings Institutions appreciates the opportunity to appear before you within the context of a major review of the Nation's housing policy. We applaud the introduction of S. 565 as an important vehicle to re-focus our Nation's efforts in the arena of housing.

Clearly the pressing needs of America's growing ranks of homeless must be addressed, as well as meeting the housing needs of those who cannot house themselves without direct federal assistance. We will focus our comments today on the sections of S. 565 that address homeownership affordability.

Changing Mortgage Markets:

I would like to briefly focus on the Nation's mortgage finance delivery system that provides the financing for homeownership, and the foundation of our political and economic system. The unspoken federal housing policy for the mortgage markets over the past few years has been to take actions that lower the costs to homebuyers by greatly expanding the potential sources of investors in mortgages. This has served to create the largest, most liquid capital market in our economy. Mortgages are reaching out to new investor groups continually, with no end of this trend in sight. No longer is the availability of mortgage credit in question.

In the past 15 years, the Congress has worked hard to make mortgage markets more efficient and open to new investors by:

- encouraging ERISA to allow greater pension fund investment in mortgages;
- improving tax treatment on foreign investors in mortgage-backed securities (MBS);

- allowing the secondary market agencies, Fannie Mae and Freddie Mac, to purchase ever-increasing mortgages by indexing their mortgage purchase limits to inflation;
- passing the Secondary Market Enhancement Act, improving the market for private MBS; and
- authorizing Real Estate Mortgage Investment Conduits (REMICs), enabling MBS to be tailored to the needs of different investors such as pension funds, insurance companies, commercial bank trust departments, and thrifts.

These actions, supported by the National Council, have served to make mortgage markets extremely efficient, and borrowers and our economy have benefited. However, the profits of investing in mortgages for thrifts have diminished dramatically. Over the past 10 years, the clear beneficiaries of this federal program to expand sources of private sector funds for housing without direct subsidies have been the homebuyers and sellers, and that significant part of the economy that benefits from strong housing markets.

Having discussed the broad mortgage markets, I would like to address some of the specific questions raised in your letter.

First-time Homebuyers

Disturbing trends of declining homeownership over the past decade in the 25-35 year old age group certainly demonstrates that the Congress must examine and address this problem. S. 565 represents a significant effort in this regard, and these hearings will certainly provide valuable insight regarding the best procedure to address the problem.

Other than the cost of the house itself, the two major problems confronting first-time homebuyers in getting mortgage financing are accumulating the downpayment and qualifying for the loan. While interest rates have remained relatively low and the ability of borrowers to carry a monthly payment has been strong, the first-time buyer has met significant problems in accumulating funds to cover closing costs and the downpayment, which, in the case of a second-time buyer, comes from the proceeds of the sale of the first house.

The difficulties in accumulating funds for downpayments have been exacerbated by a reduction in availability for conventional (non-FHA, non-VA) loans with only five or ten percent down. These loans have been offered by fewer and fewer lenders as mortgage insurance companies have pulled out of high loan-to-value lending in all but the strongest markets. This is because the lack of inflation has greatly increased the risk in lending on low downpayment loans.

In fact, the vast majority of real estate losses today stem from the reduction in inflation that drove real estate prices up consistently through the late 1970s and early 1980s. Deflationary trends appeared in many parts of the country and were most significant in regions with dominant industries suffering severe problems, such as the oil patch and agricultural regions.

During the highly inflationary 1970s and early 1980s, the escalating values of real estate covered up many of the problems of poor underwriting. If borrowers could not meet monthly payments, properties could be sold profitably and loans paid off without the need of going through foreclosure. Borrowers would struggle to pay mortgages representing a higher and higher percentage of monthly income because the investment return on the property was so great.

During deflationary times, however, if a borrower could not meet his payments, the ability to sell the property and recover losses evaporated. Exacerbating lenders' problems were borrowers who could make payments but exercised their option to walk away from a property. This often happened when a homeowner saw a neighbor's house selling for less than the outstanding principal balance on his own house, so the sacrifice of making monthly payments appeared to be too great.

Higher LTV Equals Higher Risk

The National Council must express its concern over providing FHA financing with less borrower equity. Loan-to-value has been a particularly sensitive measure of relative risk because it delineates the degree to which the borrower has a stake in the property, especially in the early years of the loan. In 1985, Moody's Investors Services did an extensive analysis of the private mortgage insurance industry. The study looked at the nature of risk from a lender's or insurer's point of view. A copy of that study is attached as Exhibit #1.

In order to examine the relative risk of loans by original loan-to-value ratios and to compare the experience of firms over time and under various economic situations, Moody's requested and received claims/survivorship data by loan type, loan-to-value, and year of origination for seven firms in the industry. These seven firms represented 90 percent of private mortgage insurance in force at that time.

Based on ever-to-date claim rates for combined data sets, the study reflected the general experience of the mortgage insurance industry on more than four million loans classified by loan-to-value. Based on data on all loans originated by these

seven firms from 1957 to 1983, loans with 5% to 9% down (91%-95% LTV) were 1.69 times as risky as loans with 10% to 14% down (86%-90% LTV), and 3.25 times as risky as loans with 15% to 19% down (81%-85% LTV).

Section 211(B)i of S. 565 would lower downpayment requirements to 3 percent on the first $50,000 and 5 percent thereafter. Because the FHA program allows borrowers to finance points, that is to include these charges in the mortgage amount, this provision would allow mortgages to be made that basically represent the value of the house. A homeowner owning a home whose sales price is equal to the mortgage amount is not really an owner of anything but a monthly payment.

Section 211 (B)ii further reduces downpayments for first-time homebuyers to only 3 percent of the entire loan amount. This is even more risky. Certainly the provision in Section 211 (b) requiring borrower counseling may help mitigate losses, but only if these programs are intensive. These programs are not inexpensive to operate if done correctly, and we would urge the Subcommittee to review counseling programs operated under the EHOP (Earned Homeownership Program), which operates out of McKeesport, Pennsylvania. EHOP has established a very impressive track record of getting people into homes that would not otherwise be approved for mortgages. However, their average cost of counseling is $2,800 and the average length of time is from six to twelve months.

To the extent that efforts are made to lower FHA downpayments, it is inevitable that losses will increase at the FHA program. We support the FHA insurance program in its current form, and would raise a concern that lowering downpayments, and increasing future losses, could jeopardize the FHA program in these increasingly tight budget times.

We would suggest that language in Section 211 (c) requiring new ARM programs to be approved only if the Secretary of HUD "finds that the new mortgage does not expose the insurance fund to excessive risk of loss" also be applied to the new section authorizing low downpayment loans.

Use of 401(k) and IRAs for Downpayments

The National Council strongly supports section 221, which would authorize the use of an individual's 401(k) retirement plan or IRA for a downpayment on a home. While these funds can currently be invested in stocks or other investment vehicles, we think that allowing a dual purpose of providing homeownership, and what most often is a very strong investment, should be allowed by the tax code.

Containing Housing Costs--Examining Local Land Use and Zoning

A major element of housing costs and barriers to homeownership for first-time homebuyers is often driven by the fact that affordable housing simply cannot be built. Minimum density levels, land use, and other local ordinances and zoning requirements create a mix of high-cost only housing. Those with less than upper-incomes cannot afford such housing and must commute long distances to work.

Section 105(b)(4) requires state and local housing authorities to "explain how the cost of housing or the incentives to develop, maintain, or improve affordable housing are affected by public policies, particularly by policies of the jurisdiction, including tax policies affecting land and other property, land use controls, building codes, fees and charges, growth limits, and policies that affect the return on residential investment, and describe the jurisdiction's strategy to remove or ameliorate any negative effects of such policies."

This language is very broad and does not provide enough direction. It seems inconsistent that the Federal government may undertake new programs to make financing easier, albeit at substantial risk to the Federal government, without requiring local jurisdictions to do everything they can to focus on the cost of homeownership as a result of actions taken by those local and state jurisdictions.

We would encourage the Subcommittee to study the results of the Joint Venture for Affordable Housing (JVAH), a program initiated by HUD and the National Association of Homebuilders's National Research Center in 1982. To quote from a recent article by NAHB economist Michael Carliner, "In 132 recent projects developed in connection with the JVAH, the average savings per unit in land and construction costs was $8,573. The savings can be grouped into four categories:

- Land use regulations (density restrictions);
- Development standards (street width, sidewalk requirements, less expensive sanitary and water pipes, etc.);
- Construction innovations in building the structure (wider spacing of studs, new plumbing and electrical material, etc.);
- Streamlined processing."

While the demonstration was fairly limited, and its results cannot be taken as results that would uniformly work nationally, it should be taken as strong evidence that more can be done to develop affordable housing through actions taken at the local level. The entire article is attached as Exhibit #2.

Risk-based Capital Regulations

Finally, I would like to raise an issue that is very important for affordable housing but is not mentioned in the legislation. Late last year, the Federal Home Loan Bank Board proposed risk-based capital regulations that will require thrift institutions to maintain certain capital levels based on the risk of the assets held by the institutions.

The Bank Board's proposal places conventional multi-family loans in the riskiest category, along with unsecured commercial loans, and this will provide a major disincentive for lenders to provide financing for rental housing. The proposed regulation makes no distinction for loan-to-value ratios and we feel treats sound multi-family loans unfairly.

We would urge this Subcommittee to do all that it can to suggest to the Bank Board that prudently underwritten multi-family loans with a loan-to-value ratio of less than 75 percent be treated the same as single family loans with loan-to-value ratios of less than 80 percent. A letter sent by the National Council to the Bank Board on this proposed regulation is attached as Exhibit #3.

Mr. Chairman, thank you for the opportunity to have appeared before you today to present our views on how this nation can best address its housing needs. I would be happy to answer any questions that members of the Subcommittee may have.

Exhibit #1

Focus On **STRUCTURED TRANSACTIONS**

Industry Outlook: Private Mortgage Insurance

Private Mortgage Insurance: An Industry in Transition

March 1985
Moody's Investors Service

Appendix 2 - Risk Analysis

Detailed analysis of risk exposure is a key element in Moody's assessment of the mortgage insurance industry and one which we have found especially useful in measuring relative strengths and weaknesses of the major firms in the industry. A mortgage insurance company's risk exposure reflects the combination of many different elements, all of which relate directly to the net equity position of loans within a portfolio and/or the ability to meet scheduled changes in monthly payments. The major risk elements include the following:

- The geographic dispersion of business,
- The loan-to-value mix,
- The type of loan instrument and loan characteristics, and
- The relative price appreciation on the underlying collateral for the loans insured, usually associated with the relative age of the loan portfolio.

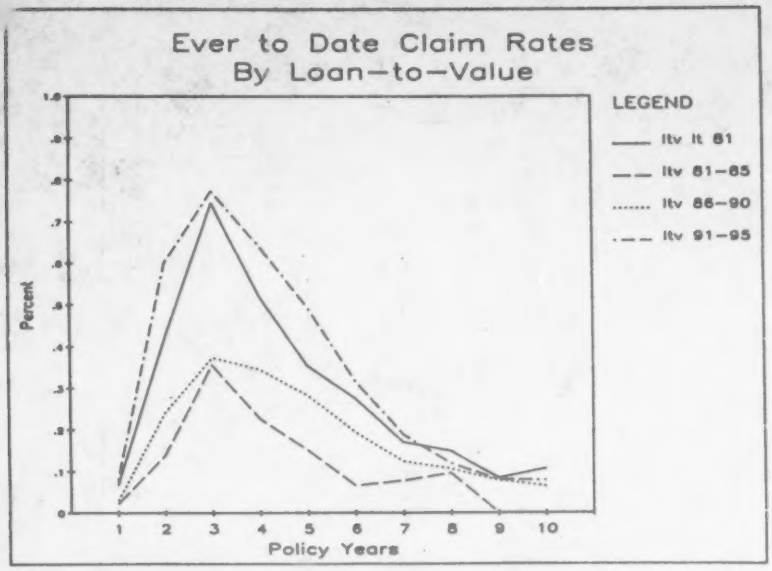
Location of a property is a particularly important element. Local economic conditions affect the probability of default of an individual loan more than the national economy does. Consequently, the greater the geographic distribution of a firm's risk exposure, the less risk there is that purely local economic dislocations will significantly affect the company's performance.

Perfect geographic distribution (with all other things being equal) would imply a distribution in proportion to the observed distribution of all private residences. However, localities are not equal in their vulnerability to economic dislocation. Default statistics by state indicate that certain states have had consistently higher default rates and others have had consistently lower ones. (See Table 3.) A firm's performance could therefore be improved if it concentrated in areas of lower default. To a great extent, the industry has followed this pattern, since lower default rates are often associated with economic expansion and growing land values and house prices. However, boom markets sometimes fall upon hard times, like the Houston housing market. Thus the traditional method of managing risk, of spreading out risk exposure as best one can, remains the optimal long-run strategy.

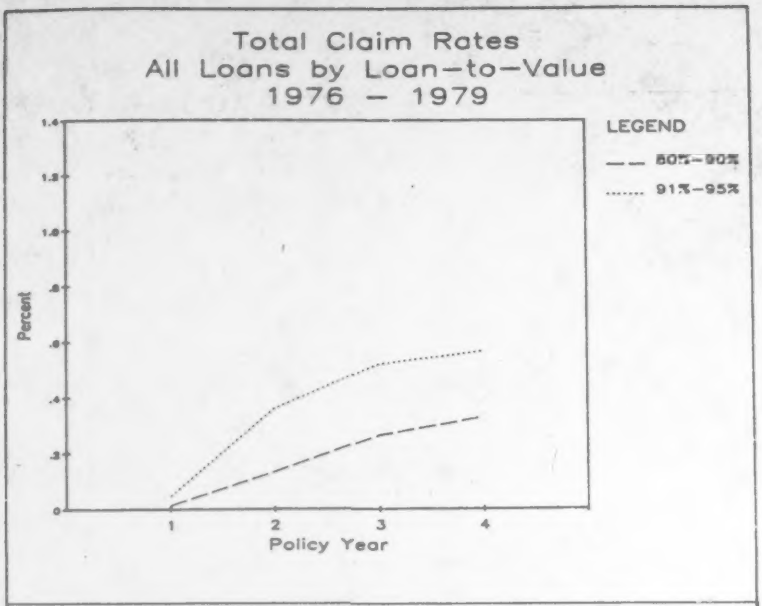
Table 4 displays the geographic distributions of those firms currently rated by Moody's and compares them with the industry average. The larger and older firms in the industry generally have better geographic distributions and lower state concentrations.

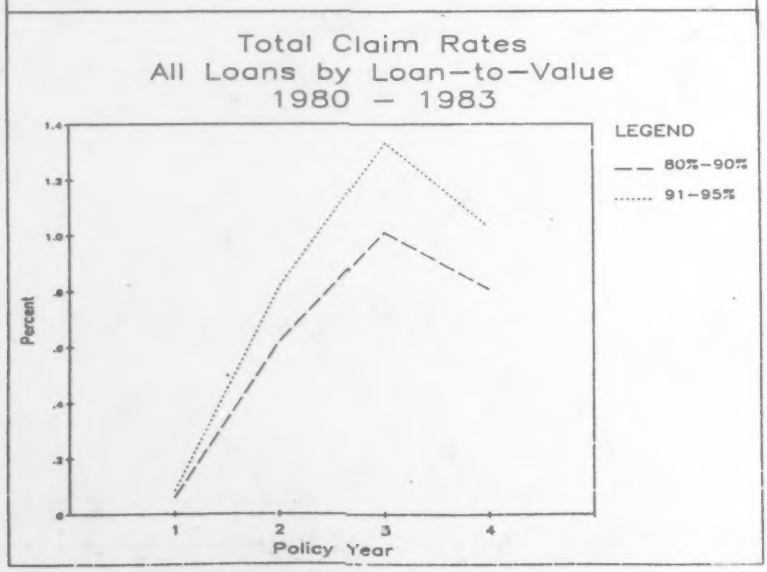
Loan-to-value has been a particularly sensitive measure of relative risk, since it delineates the degree to which the borrower has a stake in the property, especially in the early years of the loan. The higher the down payment, the less is the likelihood that the borrower will walk away from the loan. In order to examine the claim risk of loans by original loan-to-value and to compare experience of firms over time and under various economic situations, Moody's requested and received claims/survivorship data by loan type, loan-to-value, and year of origination from seven firms in the industry. These seven firms currently account for 90% of private mortgage insurance in force.

Based on ever-to-date claim rates for combined data sets, the graphs opposite reflect the general experience of the MI industry on more than 4 million loans classified by loan-to-



The graph shows the claim rates by policy year of all companies included in the peer group. The data are based on the default experience of over four million privately insured loans originated between 1957 and 1983.





These two graphs show claim rates over two seperate time periods. The higher claim rates experienced during the 1980-1983 period can be attributed to the combined effects of high unemployment and low price appreciation.

value. Based on data on all loans originated by these seven firms from 1957 to 1983, loans with 5% to 9% down (91%-95% LTV) were 1.69 times as risky as loans with 10% to 14% down (86%-90% LTV), and 3.25 times as risky as loans with 15% to 19% down (81%-85% LTV). Loans with more than 20% down usually do not require private insurance. Those that do, however, usually entail some additional risks--chief among them are status as a vacation home, a non-owner-occupied property, or location in a declining or marginal area. As a result, privately insured loans with less than 80% LTV have exhibited default rates which exceed even those loans with only 5% down.

Seasoning is an element which is generally associated with growth in net equity position. While loan balances are paid down over time, early principal payments are quite small for several years. Consequently, most of the growth in net equity is due to market value appreciation. Net equity position, over time, has been established as the key determinant of default probabililty by several studies of FHA data and has been confirmed for conventional loans by other researchers using loan data from MGIC. We have reaffirmed these conclusions using our own model of default probability, based on an even larger data base assembled from the seven MIs.

Moody's examination of claim termination rates over various periods of time indicates that inflation-induced equity positions of the 1970s were clearly responsible for keeping MI claim termination rates so low. Also from analysis of MI claim data, low future home price appreciation implies that relatively unseasoned loans, as well as all new loans insured, will incur higher default rates in the future than has been the industry's experience to date.

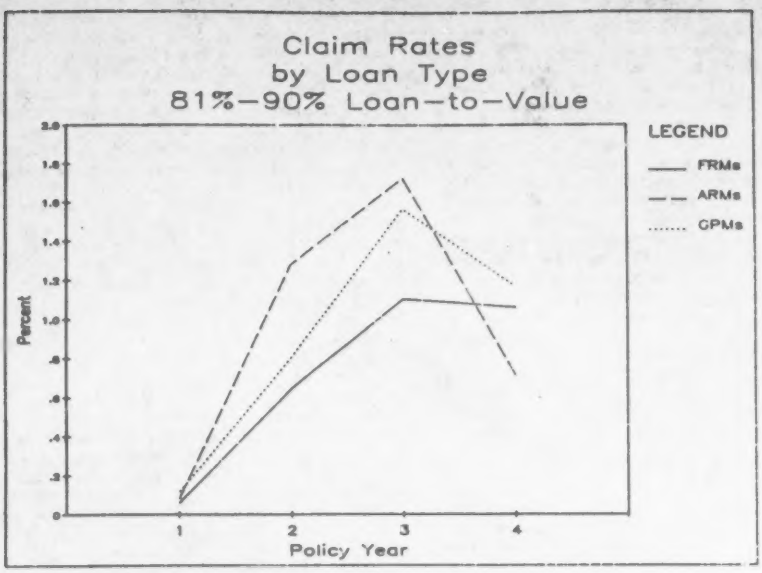
The same model and analysis were also used in estimating probable default rates and claim losses under various economic scenarios. Rather than defining a depression scenario by an assumed default rate on all loans, Moody's method assumes a slide in home values over time, coupled with rising unemployment and falling interest rates, to determine default rates based on the current makeup of the risk exposure of a particular firm. Those firms with less risk exposure (especially in terms of greater seasoning) would suffer lower default rates and losses than a firm with a higher degree of risk exposure.

The development of new types of loan instruments has introduced new elements of risk, some aspects of which are speculative in nature and cannot be actuarially defined. These instruments were originally designed to address the issue of housing affordability; by 1979, high interest rates and continued home price inflation had made home ownership difficult for many first-time homeowners. Adjustable-rate mortgages were later introduced, not only to reduce early-year interest costs but also to provide intermediaries with a reduction in interest rate risk.

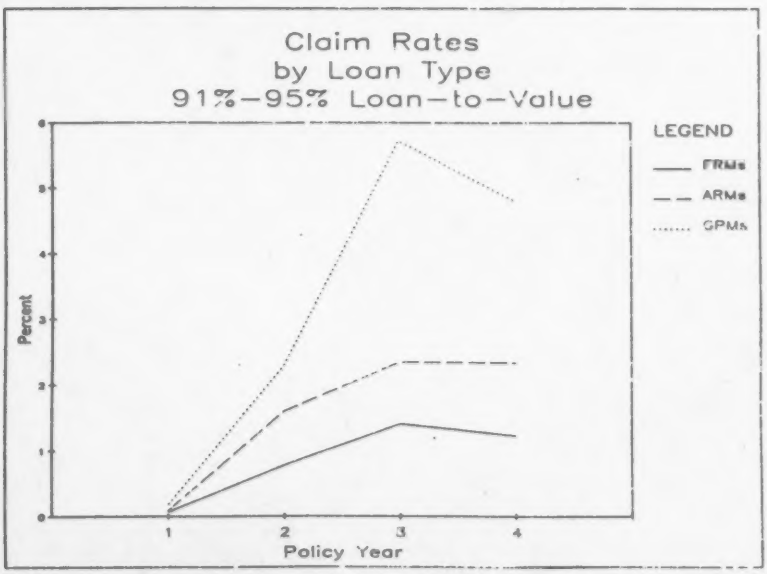
Differences in loan types affect both the borrower's equity position and his ability to make payments. Payments on normal, fixed-rate conventional loans are level, with speed of principal repayment determined by the coupon rate and the term to maturity. As long as a homeowner maintains employment and incurs no additional debt, his ability to meet monthly payments will not likely be affected. Many of the new loan instruments involve scheduled or potential changes in monthly payments. Such loan instruments assume that a borrower's income will increase over time at some minimum growth rate to meet the planned or unplanned adjustments to monthly payments.

Examples of the various loan types and their effect on payments and equity vary considerably. Most graduated payment mortgages (GPMs) have fixed interest rates but scheduled payment increases, as well as planned limited negative amortization in the early years of the mortgage. Growing equity mortgages (GEMs) have no negative amortization but do have scheduled payment increases, which rapidly increase the borrower's equity position. Builder buydowns were introduced to reduce interest costs in the early years of loans. Depending upon the size of the buydown, monthly payments increase to full regular payments within one to three years.

ARMs potentially can include all of the above characteristics, depending on what loan features have been adopted for a particular loan. The variety of features in ARMs makes this particular instrument difficult to assess and to track over time. However, there has been a marked trend toward greater standardization in ARM instruments, which will improve our ability to assess the risk exposure presented to mortgage insurers.



Rates are based on 1980-1983 data. Note the decline in fourth year ARM claim rates. ARMs of this age were mainly three-and five-year ARMs whose payments were adjusted downward in 1983 due to lower interest rates.



Rates are based on 1980-1983 data. The lack of a drop in fourth-year ARMs claim rates is primarily due to the smaller initial equity position in such loans and the lack of any significant home price appreciation.

The graphics on the opposite page highlight the information gathered by Moody's on three of the major loan types insured by our sample of seven MIs. The data are compared for the years 1980-83 only. While some GPMs and types of ARMs were insured before 1980, their numbers were too small to be meaningful. Claim rates on fixed-rate standard mortgages referred to in the graphics were taken from the same 1980-83 period, so that the same economic forces and events affecting GPMs and ARMs would be accounted for. Claim rates on standard fixed-rate loans before 1980 conform most closely with the claim rates discussed in the section on loan-to-value.

Based on a sample of 578,490 fixed-rate standard mortgages (FRMs), 53,555 GPMs, and 219,691 ARMs, GPM loans with 81%-90% LTV were 28% more likely to default than fixed-rate standard conventional loans, while ARMs were 32.2% more likely to default. We attribute the surprisingly low difference in observed claim termination rates to the fact that the bulk of the seasoned ARMs in this period were three- and five-year ARMs, whose first adjustments were made at a time of declining interest rates. Most of the one-year ARMs currently outstanding were originated in 1983 and 1984. Therefore, the effects of sharp upward payment adjustments are largely not present in the 1980-83 data. Despite these caveats, ARMs with 95% LTV were 84.6% more likely to default than FRMs. GPMs in the 91%-95% LTV range defaulted at a rate 3.73 times that of FRMs.

At this point, until more clearly defined ARM data are available, it would apear that GPMs may be our best proxy for potential ARM credit risk. Nearly all of the GPMs in the sample carry scheduled payment increases of 7.5% for the first five years, as well as some built-in negative amortization. Since 7.5% payment increases correspond roughly to a 1% interest rate cap, one might further speculate that loans allowing a 2% annual cap might carry potential claim frequencies that would be more than twice the credit risk of 1% caps. Data from 1984 and the next several years will be required before we can obtain a fuller understanding of the true potential risk of these instruments.

Moody's has reached the following conclusions, based on this vast array of information and our modeling simulations:

1) Given the large degree of difference in past claim termination rates between 91%-95% LTV loans and 81%-90% LTV loans and the relatively small difference in their pricing, cash flow analysis suggests that until the most recent adjustments in premium rates, 91%-95% LTV loans were underpriced relative to potential claim losses.

2) Unseasoned and higher LTV loans will likely suffer higher claim rates in the future, due to expected lower home price appreciation in the future.

3) Certain risk elements, when combined with other riskier characteristics, appear to have an exponential effect on default rates, as demonstrated by the GPM and ARM data.

4) Also based on GPM and ARM observations, such loans originated before recent premium changes were seriously underpriced relative to their inherent risks.

Exhibit #2

Regulatory Costs and Affordable Housing

Michael Carliner

Home building is a highly regulated activity. Perhaps in no other industry must the producer obtain permission for each individual unit of production. The basis of such regulation includes the perceived need to protect the home buyer, but is largely a reflection of the externalities of home building—the effects on third parties, especially neighbors.

The effect of regulation on the affordability of housing is undoubtedly negative. The extent to which housing cost is increased is difficult to measure, however, in part because the standard of comparison—the cost in the absence of regulation or under a regime of only "necessary" regulations—is not well defined.

The Joint Venture

One valuable indication of the nature and magnitude of costs associated with regulations is the savings achieved under demonstration projects of the Joint Venture for Affordable Housing (JVAH).

The JVAH is a program initiated by HUD in 1982 involving the housing industry and state and municipal officials. Developments were built in sites throughout the country, where local officials agreed to relax normal regulations and simplify the approval process. NAHB's National Research Center was heavily involved in arranging the demonstration and assessing the results.

The extent to which regulations were relaxed, the restrictiveness of the original regulations, the extent to which savings represented actual regulatory change (rather than changes that could have occurred without changing regulations), and the type of housing varied among the demonstration projects. These demonstrations were by no means controlled scientific experiments. The information obtained from the JVAH demonstrations does, however, provide some valuable insights.

In 132 recent projects developed in connection with the JVAH, the average savings per unit in land and construction cost was $8,573. The savings can be grouped into four categories:

- Land use regulations (density restrictions)
- Development standards (street width, sidewalk requirements, less expensive sanitary and water pipes, etc.)
- Construction innovations in building the structure (wider spacing of studs,

Table 1 Savings in Demonstration Projects

Place	Total Unit Savings	Admin. & Process Savings	Land Dev. Savings*	Direct Constr. Savings	Price Range	Savings Based on Avg. Price
Blaine, MN	$4,963	$283	$2,680	$2,000	$44,900/48,900	10.6%
Birmingham, AL	4,278	86	4,191	—	51,900/58,900	7.7
Boise, ID	2,119	—	2,119	—	65,000/95,000	2.6
Christian Cty., KY	8,886	(400)	3,279	6,007	28,000/37,400	27.2
Crittenden Cty., AR	6,294	—	4,789	1,505	26,885/35,040	20.3
Elkhart Cty., IN	855	—	855	—	37,500/54,920	1.8
Everett, WA	10,047	1,477	7,089	1,418	64,500/76500	14.3
Knox Cty., TN	2,545	443	1,487	615	43,500/55,000	5.2
Lacey, WA	7,396	2,052	3,083	2,261	39,000/62,000	14.6
Lincoln, NE	7,045	1,116	4,953	975	38,450/46,000	16.7
Mesa Cty., CO	5,663	770	3,174	1,313	39,000/47,500	13.1
Oklahoma City, OK	5,477	181	5,296	—	39,000/57,500	11.4
Pheonix, AZ	8,037	2,198	3,674	2,165	45,000/63,000	14.9
Portland, OR	15,647	2,047	12,387	1,213	50,000/55,000	30.0
Santa Fe, NM	9,140	2,992	3,845	2,303	49,950/61,950	16.3
Sioux Falls, SD	1,640	—	1,640	—	55,000/70,000	2.6
Tulsa, OK	13,969	—	10,390	2,079	47,000/63,000	25.4
Valdosta, GA	9,685	300	7,650	1,735	42,500/46,500	21.8

* Including savings from higher density

new plumbing and electrical materials, etc.)

- Streamlined processing

Of these, the biggest savings came from changes in density and changes in the development standards. Changes in the way the home itself was built accounted for smaller savings, and streamlined processing, while significant, accounted for the smallest savings. The distribution of savings reported for some earlier JVAH demonstrations is shown in Table 1.

...the biggest savings came from changes in density...

Most of the JVAH savings involved changes in the character and performance of the home, rather than simply the elimination of inefficiencies. Streamlined processing is probably an example of pure savings, with no impact on the product. Use of newer wiring and plumbing materials may be essentially invisible to the homeowner. But those changes don't have large effects on the price of homes. The changes that translate into substantial differences in price are those that involve readily-apparent alteration of the product, such as smaller lots, narrower streets, or the elimination of sidewalks. Regulations increase costs primarily by requiring features that might not be demanded by informed homebuyers in an unregulated market, rather than simply by requiring that homes be produced using archaic methods and materials.

Most features mandated by regulations are viewed positively by home buyers in the absence of cost considerations. Most homeowners prefer having a larger lot to a smaller lot, for example. Even where the regulations result in a product that is viewed by home buyers as being of higher quality, however, the homebuyer might prefer a lower cost, if the choice were offered.

Other features mandated by regulations are viewed as neutral or negative features by the home buyer. For example, requirements of wide street widths encourage more through traffic and higher speeds, presenting increased danger to children playing in the neighborhood. Requirements for sidewalks mean that homeowners must shovel snow and otherwise maintain those sidewalks. While such requirements have limited attraction to home buyers, they are arguably important to other members of the community who want to travel through the neighborhood.

Land Use Regulation

Most (about 3/4) of the savings in land and development cost in the JVAH are attributed to changes in density. By allowing more units to be built on the same amount of land, the land cost per unit is reduced. Also, smaller lots mean lower development costs because the cost per lot for streets, etc., is reduced as well.

The savings shown from higher density in the JVAH were due to the fact that the land had already been purchased with a price based on existing density restrictions, and the builder committed to passing on the savings to the home buyer. If the supply of land subject to high-density zoning is artificially restricted, the raw land cost of a quarter-acre lot will normally be nearly as high as for a half-acre or larger lot, since the price will reflect the value of permission to build a house, rather than the inherent value of the amount of land. Only if an adequate supply of land is zoned as high density will the cost of land be roughly proportional to the size of the lot.

In addition to the cost of raw land, the cost of a developed lot will reflect the cost of improvements and of development fees. A 1987 NAHB survey found that the national average breakdown of the cost of developed lots was as follows:

Raw Land	38%
Development Cost	39%
Fees	23%

The cost of development reflects the standards in the local subdivision ordinance. Where builders are required to build suburban residential streets to the same standards as major urban thoroughfares, with square curbs and wide sidewalks on both sides, it makes a big dent in affordability. Requirements that structures be set way back from the street and other restriction on the placement and character of structures will further add to cost and may even offset the advantage of high-density zoning by effectively setting the minimum lot size.

The Building Code Process

Rules regarding the manner in which homes are constructed are primarily the province of local government, administered by over 9,000 local agencies. Most localities base their building codes on one of three national model codes. The model code developed by Building Officials and Code Administrators International is followed by most jurisdiction in the Northeast. The model of the Southern Building Code Congress (SBCCI) is followed by most jurisdictions south of the Virginia-North Carolina border and east of Dallas. The dominant model in the West is the code developed the International Conference of Building officials. Those codes cover all types of buildings.

The three model code organizations are joined in an umbrella group called the Council of American Building Officials (CABO). There is a special CABO code for one and two family dwellings that is simpler and somewhat less restrictive than the model codes designed for all building types. Where CABO is recognized, a home builder has the option of building in conformity with either the CABO code or the relevant one of the three general model codes.

The national model codes are regularly amended, with new editions issued every three years. In general, the model codes adequately reflect new technologies and do not impose unreasonable requirements.

New versions of the model codes are not automatically adopted by localities. There must be an explicit action. When localities do adopt new versions of the model code they often add amendments of their own or adopt only parts of the model and retain sections based on older editions of the model codes.

While there are some unnecessary costs as a result of delays in adoption of code revisions, most of the adverse cost impact of building codes comes in the interpretation of codes and in inspections. There is an institutional bias in the administration of building codes against departures from accepted practice, and building code officials feel no obligation to take a proactive role in promoting housing affordability.

most of the adverse cost impact of building codes comes in the interpretation of codes and in inspections

Rather than face the possibility of rejection or delay, builders tend to shy away from seeking acceptance of new methods. The significance of the administration—rather than the adoption—of building codes and the problems with diffusion of new technology are reflected in the fact that about half of the savings from construction innovations claimed by participants in the Joint Venture come from changes that were permitted under preexisting Codes.

The Politics and Legality of Regulation

Regulation of land use and construction is primarily a responsibility of local government. The authority for imposing such regulations derives primarily from local police powers to protect public safety, health, and welfare. Although the powers of localities vary among states and among localities within states, their legal authority is circumscribed by state and federal law.

The economic interests and social preferences of current residents often favor restrictions on overall growth, limitation of new construction to very expensive homes, or requirements that new developments include amenities that benefit long-term residents. Certainly, if the use of lower-cost methods and materials permits a builder to provide new homes at 20% lower cost than my home and the new home provides equivalent service, the value of my home will be adversely affected.

When localities impose regulations that further the economic interests or social preferences of current residents without a valid basis in terms of health and safety, they do so on tenuous legal grounds.

Some local regulations would not stand up in court, but the fact that they are illegal doesn't mean they are not present and effective. Builders are not willing to challenge regulations because the cost and time of a legal challenge would not be cost-effective. Moreover, they cannot afford to antagonize regulators with whom they hope to work successfully in the future.

State governments have a broader constituency and a different set of incentives than local governments. They can't blithely decide that poor people can just go live somewhere else. Increasingly, states have become active in ensuring that all communities provide affordable housing. The authority of local governments derives from the states. This is in contrast to the relationship between states and the federal government, where state sovereignty is somewhat protected.

The federal government's role in local regulatory matters is more limited, both by practicalities and by legalities. Restrictions on federal funds theoretically provide some leverage, but unlike highway funds, where that leverage is overwhelming, there isn't enough money in federal housing assistance to scare anyone, and exclusive communities are perfectly willing to forego federal subsidies.

The federal government can play an important demonstration role and has attempted to do so in the JVAH. The JVAH demonstrations have been of limited effectiveness, however, in changing behavior. Even in those communities where demonstrations have occurred, the relaxation of regulations has not always extended beyond the demonstration. Despite widespread media attention to housing affordability, the JVAH is rarely mentioned and is not well known. Perhaps that situation will change under a new, highly-visible HUD Secretary.

Conclusion

Unnecessary regulations contribute significantly to housing cost, and have a particularly adverse impact on the construction of housing for lower-income households. It is often in the discretionary exercise of regulatory authority, rather than the legislative function by which regulations are adopted, that unduly restrictive regulation occurs. This makes it difficult to solve the problem by legislative means.

The federal government's role in local regulatory matters is...limited...

Building inspectors and builders often are not adequately conscious of the opportunities for cost-saving innovations. An effective program of demonstrations and public information could have substantial impact on the availability of affordable housing. The federal government can more effectively encourage cost-saving regulation and practice.

State government may play the primary role in ensuring that localities do not abuse their authority. States can see to it that localities don't use housing regulations to exclude people from their communities or impose inequitable burdens on new residents.

Exhibit #3

National Council of Savings Institutions

Dr. Mark J. Riedy
President and Chief Executive Officer

March 17, 1989

RECEIVED
MAR 17 10 06 AM '89
INFORMATION SERVICES

VIA MESSENGER

Director, Information
Services Division
Office of the Secretariat
Federal Home Loan Bank Board
1700 G Street, N.W.
Washington, D.C. 20552

Re: Proposed Rulemaking, Regulatory Capital Requirements for Insured Institutions

Dear Sir or Madam:

The National Council of Savings Institutions appreciates the opportunity to present its views on the Federal Home Loan Bank Board's proposed rule concerning regulatory capital requirements for insured institutions. The National Council has long supported stronger, more meaningful capital requirements, and commends the Federal Home Loan Bank Board's efforts to propose standards for capital adequacy that realize the need for higher levels of capital, while recognizing the ability of the industry to meet those levels within a reasonable time. The National Council is a trade association representing savings banks and savings and loan associations nationwide. Its 500 members hold approximately $550 billion in assets, about 35 percent of the industry's total assets. Its members are the better-capitalized and more profitable institutions of the industry, and support pro-competitive positions on financial services issues.

I. Background

On December 15, 1988, the Federal Home Loan Bank Board (the "Bank Board") proposed for comment substantial revisions to its regulations under 12 C.F.R. Part 561 and 12 C.F.R. Part 563, defining regulatory capital requirements for insured institutions (the "Capital Proposal"). The Capital Proposal will establish new capital requirements on the basis of certain risks in an insured institution's portfolio. The proposed risk-based capital requirements anticipate that institutions will maintain a minimum capital level equal to the higher of two requirements. The first requirement, based on credit and interest-rate risks, will equal approximately 8 percent of risk-weighted assets. The alternative requirement will, if implemented in its present form, equal 2 percent of an institution's total assets.

The National Council established a task force to study the Bank Board's proposal. The task force was comprised of a broad cross-section of institutions from the National Council's membership. The stated goal of the task force was to analyze the practical implications of the Capital Proposal on the industry, to ascertain which aspects of the Capital Proposal were satisfactory to the industry, and to recommend changes beneficial to the industry as well as to the federal deposit insurance system.

On February 9-10, 1989, the Bank Board heard testimony from the industry at an informal public hearing. The National Council participated in those hearings, and gave its views on the proposal, based on an initial meeting of its task force. The written statement submitted to the Bank Board basically stated that the Capital Proposal was, indeed, based on the agreement with banking authorities of other countries (the "Basle Agreement") that had been adopted by the United States banking regulators, and to that extent was acceptable. At the same time, however, the National Council noted that the Capital Proposal differs from the Basle Agreement in many significant respects. The National Council concluded, based on the recommendation of its task force, that many of these differences were particularly onerous and impracticable from a compliance aspect, and, in fact, could actually work to the detriment of the savings industry.

Since the public hearing, the Bush Administration has released its proposal to resolve the crisis facing the savings industry, which was introduced in the United States Senate on February 22, 1989, and introduced in the House of Representatives on March 6, 1989 ("FIRREA"). FIRREA, inter alia, proposes to authorize the chairman of the successor organization to the Bank Board (the "FHLBS") to establish, not later than 90 days after its enactment, uniformly applicable capital standards for savings associations. The standards, which shall not be less stringent than the capital standards applicable to banks, are to be fully implemented by no later than June 1, 1991. FIRREA establishes other timetables and standards that are inconsistent with provisions contained in the Capital Proposal.

At the outset, the National Council believes that it is imperative for the Bank Board to reconcile any discrepancies between its original proposal and FIRREA, if and when that legislation is enacted. This document, however, will primarily focus on the rule that was proposed for comment on December 15, 1988. Where necessary, we reserve the right to offer our comments or suggestions concerning provisions of FIRREA that are likely to become law, and thus affect this rulemaking proceeding.

II. Miscellaneous Credit-Risk Categories

The Capital Proposal contemplates establishing six broad categories to which thrifts' assets are assigned based on the amount of credit risk associated with a particular class of assets. These categories are roughly equivalent to those

assigned by United States banking regulators based on the Basle Agreement. The Bank Board is under no obligation to follow these categories, however, and has, in fact, departed from the categories established in the Basle Agreement in several significant respects. The National Council believes that many of the risk weights contained in the Capital Proposal are appropriate, or, in any event, that actual experience does not clearly establish a more appropriate treatment. There are, however, several risk categories that we believe require adjustment.

The National Council believes that a change is needed for home equity lines of credit and other junior mortgages under certain circumstances. Under the Capital Proposal, these instruments are categorized as consumer loans, and are given a 100-percent risk weighting. We note, however, that many of these loans are secured by second liens on residential property. Furthermore, the first and second liens combined do not exceed 80 percent of the value of the security property. In such cases, the credit risk of these loans is no higher than the credit risk associated with first-lien, purchase-money mortgages with loan-to-value ratios of 80 percent or less. We believe, therefore, that they should be placed in the 50-percent category, and, moreover, should come within the definition of a qualified mortgage.

In keeping with the spirit of congressional intent, we also believe that certain multi-family mortgages should be similarly placed in the 50-percent risk category. Multi-family loans generally refer to loans on apartment complexes, which are often the only viable source of housing for people of lesser means. We believe that a higher risk weighting will dramatically impinge both congressional and agency efforts to provide housing for people of moderate means. In order to account adequately for some existing risk differential between loans on 1-4 family residences and multi-family loans, we suggest that only those loans with a loan-to-value ratio of 75 percent or less be included within this 50-percent category.

We do not believe the treatment of real estate owned property ("REO") is appropriate. REO must be written down to market value at the time it is put on an institution's books, and therefore involves no additional risk of loss. We understand some troubled institutions have had REO that was not properly written down; the result being that even after the initial adjustment, the book value was less than actual market value. It does not follow from this experience, however, that healthy institutions are not properly valuing REO. In any event, a better response to the over-valued-REO problem is to increase supervision and enforcement of proper guidelines, not to impose what is essentially a broad-based penalty on institutions that carry this type of asset on their books.

Additionally, we believe that government agency-guaranteed mortgage loans, such as GNMAs, FHLMCs, and FNMAs, should be in the zero-risk category. The actual risk of loss due to

nonpayment is little, if any, because the government guarantees these securities. Moreover, we respectfully note that the terms of the Basle Agreement put these securities into the zero-risk category. Similarly, stock in and claims against the Federal Reserve Banks and the Federal Home Loan Banks involve almost no possibility of loss; therefore, these assets should also be classified in the zero-risk category.

III. Goodwill

The Capital Proposal, if enacted, will require that goodwill be risk-weighted at 200 percent. In many cases, goodwill has been the major asset acquired in these deals; without its characterization as an asset, there would have been no incentive, economic or otherwise, for consummating these deals. The National Council strongly believes that, in keeping with the Bank Board's original characterization of this intangible as an asset, goodwill existing on the effective date of the final rule should be placed into the 100-percent category.

Additionally, FIRREA, as introduced in Congress, contemplates that all goodwill be amortized over a ten-year, straight-line schedule commencing on the date of enactment. The National Council believes that the Bank Board must accommodate institutions that have acquired goodwill as the result of acquisitions of insolvent or troubled insured institutions. It is unfair in these circumstances to penalize institutions that were willing to help defray the costs associated with government bail-outs by changing the impact of those agreements at a time when the institutions are powerless to negotiate new bargains. For these reasons, we urge the Bank Board to consider grandfathering existing goodwill that resulted from acquisitions of troubled institutions; in such transactions, the government received an undeniable benefit, whether direct or indirect. In fact, the banking regulators have adopted this policy.[1] Given the negative impact that the proposed treatment of goodwill will have on future FSLIC-assisted acquisitions, the Bank Board must also consider, on a case-by-case basis if not by regulation, a more favorable treatment of goodwill in future deals.

---

[1] See, e.g., 54 Fed. Reg. 4168, 4179 n.6 (1989) (to be codified at 12 C.F.R. § 3.100, Appendix A) (OCC may not require national banks to deduct goodwill acquired in connection with supervisory mergers with problem or failed depository institutions), 54 Fed. Reg. 4186, 4200 n.14 (1989) (to be codified at 12 C.F.R. Part 208, Appendix A) (FRB-created exception for state banks that acquired goodwill in connection with certain mergers and given explicit authority to include such goodwill under then-existing capital policy), and __ Fed. Reg. ___ n.4 (1989) (to be codified at 12 C.F.R. Part 325, Appendix A) (FDIC-created exception for certain intangibles to be counted as capital on a case-by-case basis).

IV. Equity-Risk Investments

The Bank Board proposes that all equity-risk investments be subject to the consolidation method with a risk-weight assignment of 300 percent. The Bank Board requests comment concerning whether the exclusion method or, alternatively, the consolidation method with more specific risk weightings for different kinds of equity-risk investments, is preferable to the currently used equity method. The National Council believes that the Bank Board has correctly identified some high-risk assets among those which will be subject to this capital requirement, but we nevertheless maintain that the category as proposed is too broad.

The National Council believes that the exclusion method is generally inappropriate for equity-risk investments. As noted below, under certain circumstances the exclusion method may have advantages over the consolidation method; therefore, we recommend that it be available as an alternative in particular cases. As a rule, however, the exclusion method, with its 100-percent capital requirement, is premised on the assumption that an investment subject to this method is virtually certain to be a total loss. There is no empirical basis for this assumption. Furthermore, a soundly managed and well-capitalized institution is not likely to undertake an investment with such a high likelihood of loss. To adopt the exclusion method with respect to all equity-risk investments will unjustifiably penalize sound equity-risk investment practices. Given that the parent's exposure is limited to the amount of its investment, this method will not give rise to any additional exposure for FSLIC.

Service corporations present a prime example. Many institutions use service corporations to engage in activities that are permissible for the parent institution. Thus, for example, service corporations are handling credit card operations, originating mortgage loans, or holding the institution's REO. The assets of these service corporations, if held directly by the parent, will be weighted at 100 percent, 50 percent, and 200 percent respectively. To require an institution to reserve, in effect, 300 percent against assets merely because a service corporation is holding those assets is inconsistent. Therefore, we recommend that investments through service corporations representing activities in which the parent could engage directly should be capitalized as if the parent were making the investment directly, instead of treating the investment in the subsidiary as an equity-risk asset. Similar treatment should be afforded subsidiaries engaged in types of activities available to the parent, but operated in a manner that is proscribed to the parent, such as out-of-state operations.

The Bank Board proposes to apply the consolidation method of accounting for investments by insured institutions in subsidiaries. The National Council agrees that, under most circumstances, the consolidation method is appropriate. The consolidation method, if adopted, will impose the same capital requirement on the parent insured institution without regard to

whether an asset is held by the parent or a subsidiary. Consequently, the consolidation method allows insured institutions to decide whether to use a subsidiary on the basis of operational, legal, and tax concerns, rather than capital concerns. Additionally, in keeping with the requirements of sections 402 and 406 of the Competitive Equality Banking Act of 1987 ("CEBA"), the consolidation method is consistent with generally accepted accounting principles ("GAAP"), and bank regulatory standards.

The National Council recommends, however, that, for purposes of calculating an electing institution's capital requirement (but not for reporting purposes), the Bank Board not preclude the use of the exclusion method of accounting for investments in subsidiaries altogether. The amount of capital required under the exclusion method may, under certain circumstances, be less than the amount required under the consolidation method. When an institution, through its subsidiary, can finance its equity-risk investments at a significantly lower capitalization rate than the 18-percent capital-to-assets rate required under the consolidation method, applying the exclusion method will be beneficial to the institution and, by creating an incentive to conduct equity-risk activities in a subsidiary, will decrease the risk posed by the investment to FSLIC.

For example, assume that an institution has $100 of equity-risk investments. Its cost of capital is 15 percent and it can raise deposits at 8.75 percent. Under the consolidation method, applying a 300-percent risk weight will require the institution to maintain $18 of capital, at a cost of $2.70 (15% of $18). The institution is able to raise the remaining $82 in deposits at a cost of $7.175 (8.75% of $82). Therefore, its cost of carrying the investment is $9.875 ($2.70 + $7.175). Under the consolidation method, the holding cost is the same regardless of whether the parent held the equity-risk investment directly or through a subsidiary. The consolidation method ignores the transaction between the parent and the subsidiary, requiring the parent institution to hold $18 in capital, even if the asset is held through a subsidiary.

Alternatively, if the institution is permitted to elect the exclusion method for calculating its capital requirement, it will be encouraged to use a subsidiary that can borrow at, for example, 9 percent, using the assets as collateral. The institution can transfer the $100 of equity-risk investments to the subsidiary in return for a $90 promissory note and a $10 equity interest in the subsidiary. The subsidiary can then borrow $90 at 9 percent against the $100 of assets and pay off the $90 promissory note held by the parent. Borrowing the $90 costs the subsidiary $8.10 (9% of $90). Since the $10 capital contribution will represent an equity-risk investment, the parent will be required under the exclusion method to hold capital equal in dollar value to the value of the investment. Thus, the parent's cost of holding the investment will be $1.50 (15% of $10). The total cost of holding the assets under the exclusion method is $9.60 ($8.10 + $1.50). Compared to the previous

scenario, holding the asset at the subsidiary level results in a savings of $0.275 ($9.675 - $9.60) in holding costs.

In contrast to the consolidation method, the exclusion method differentiates between holding the equity-risk investment at the parent and the subsidiary levels, and encourages the parent to hold the asset at the subsidiary level, thereby reducing the parent's risk exposure from the full $100 to its $10 equity interest in the subsidiary. The National Council believes that applying the exclusion method under certain circumstances can encourage an institution to hold equity-risk investments in a manner that reduces holding costs, and both the institution's and FSLIC's exposure to risk of loss. We therefore suggest that the Bank Board permit each institution to apply the exclusion method to one or more of its subsidiaries at its own election.

Notwithstanding the foregoing argument, the National Council believes that, at a minimum, existing direct investment activities should be grandfathered at 6 percent and phased in to the higher 18 percent over a five-year period. Future activities will, of course, be subject to the 300-percent requirement. If the Bank Board decides to change any of the provisions regarding powers that must be exercised through subsidiaries, however, we respectfully suggest that the Bank Board base these changes on the thrift charter rather than the national bank charter.

V. Collateralized Borrowings

The Bank Board has proposed an additional capital requirement for collateralized borrowings. The proposal defines a collateralized borrowing to include any liability against which an institution "has pledged specific assets, pledged to maintain a specific value of assets, or for which the structure of a transaction could otherwise result in an effective pledging of assets." Such a broad definition includes not only stated items, such as preferred stock issued by a subsidiary, but also has the effect of including Federal Home Loan Bank advances, repurchase agreements, and finance subsidiary issuances. Thus, an institution must maintain capital in the amount of 3 percent of liabilities on which specific assets are pledged, in addition to the standard capitalization required on the underlying asset. The National Council believes that Federal Home Loan Bank advances must not be considered a collateralized borrowing. If implemented as proposed, the National Council believes that this provision may actually discourage savings institutions from using certain strategies that can significantly reduce their interest-rate risk. Also, such a provision, if included in the final rule, will impair an institution's ability to seek additional sources of badly needed, low-cost funds.

The National Council believes, however, that a collateralized borrowing is not an appropriate element of a credit risk-weighted capital requirement. Collateralized borrowings do not involve any additional risk to FSLIC. Whatever exposure FSLIC as receiver may have to third-party lenders is

offset by the collateral, and FSLIC will have the benefit of the cash or whatever assets the institution acquired with the proceeds of the borrowing. The National Council views this proposal as a response to a perception that many institutions taken over by FSLIC have pledged their highest-quality assets to collateralize specific debt issues, making these assets unavailable to FSLIC when it resolves the institution. This proposal appears to be an attempt to remove some of the existing economic incentive for insured institutions to raise funds through collateralized borrowings rather than through insured deposits.

Collateralized borrowings, however, do not actually increase FSLIC's exposure to loss. Although collateralized lenders receive the value of the collateral in liquidation, FSLIC's loss in the event of liquidation is the same whether the liabilities are exclusively deposits or include collateralized borrowings. Assume, for example, an institution with $160 in assets and $200 in deposit liabilities at liquidation. In this case, FSLIC will incur a loss of $40. If the institution did not hold all of its liabilities in deposits, but had $50 in borrowings collateralized by $100 in assets in addition to $150 in deposits, FSLIC's net loss at liquidation will be unchanged. Upon liquidation, $50 of the proceeds from asset sales goes to the secured creditor, while FSLIC receives the remaining $110. FSLIC is obliged to disburse $150 to depositors, leaving itself the same $40 net loss. Thus, the secured creditor's prior claim to the collateral does not increase FSLIC's risk.

The National Council acknowledges that FSLIC receives no premiums on collateralized borrowings to offset its costs. The Bank Board, however, has neglected to consider that, in numerous situations, benefits to an institution can be realized through collateralized borrowings in ways not available through deposits. For example, Federal Home Loan Bank long-term advances enable an institution to raise, in a short period of time and in little volume, long-term, fixed-rate obligations that can reduce interest-rate risk. Deposits cannot fulfill this function. Moreover, tax benefits that are capable of being derived from issuing collateralized preferred stock are unavailable in the case of deposits. Such benefits can substantially strengthen the finances of institutions and thereby reduce the risk to FSLIC by an amount well in excess of the loss in premiums to FSLIC. The National Council respectfully suggests that the Bank Board not discourage the use of collateralized borrowings by imposing the proposed 3-percent capital requirement. The benefits of collateralized borrowings to the industry more than outweigh FSLIC's loss in premiums.

We realize that in some situations an institution may raise funds through collateralized borrowing merely to avoid having to pay premiums on these funds. Retaining the funds that the institution might otherwise be obliged to pay in premiums to FSLIC strengthens the institution's financial condition, and consequently reduces, on a dollar-for-dollar basis, FSLIC's risk. Although the Bank Board may have legitimate concerns about its

insured institutions using collateralized borrowings in order to evade premiums, the National Council does not believe that a capital regulation is the appropriate mechanism for addressing such concerns.

VI. Off-Balance Sheet Items

The Bank Board has also proposed to incorporate so-called off-balance sheet items in its calculation of risk-weighted assets. The method proposed is similar to that which has been adopted by the Federal Reserve Board, the Comptroller of the Currency, and the FDIC. The proffered reason for the inclusion of these provisions in the proposal is to account adequately for certain commitments that are not liabilities per se, but that may, on the occurrence of an event, become a claim against the institution.

The Bank Board anticipates that risk weights for off-balance sheet items will be determined by a two-step process. The first step is to multiply the face value of the off-balance sheet item by a credit conversion factor that takes into account the chances that a liability will arise with respect to the item. This step will result in a determination of the credit-equivalent amount of the item on the balance sheet. The second step entails assigning the credit-equivalent amount to the appropriate risk category depending on the obligor.

The National Council does not object to the theory behind incorporating an institution's off-balance sheet items in a calculation of its risk-weighted assets, nor does it take issue with the method proposed for calculating the conversion. We do, however, disagree with the inclusion and specific treatment of several of the items that the Bank Board has postured in this category.

The Capital Proposal assigns a 100-percent conversion factor to direct credit substitutes. The Bank Board defines a direct credit substitute as "any irrevocable obligation in which a thrift has essentially the same credit risk as if it had made a direct loan to the obligor or account party." Thus, asset sales, if not included on the balance sheet, will be treated as if they had not occurred. In a number of these types of transactions, institutions sell packages of assets while retaining a small portion of risk that may be triggered on the occurrence of certain events.

The Capital Proposal, as written, will also require a thrift that swaps mortgages under the FHLMC's grantor program and provides recourse to maintain capital against both the participation certificates and the mortgages. The National Council maintains that this provision, if not corrected, will require such sellers of qualifying mortgages to reserve 4.2 percent, as opposed to the 3 percent that is required if the loans are simply held in the portfolio. We believe it imperative that the Bank Board clarify this issue, which directly

contravenes the practice of both the bank regulatory agencies and accountants.

This proposed treatment of asset sales with recourse will significantly affect the capital requirements of an institution that has sold fixed- or adjustable-rate mortgage loans on the secondary market as part of an effort to restructure its balance sheet. Under the Capital Proposal, if the percentage of recourse liability retained reaches a certain threshold level, an institution can be required to maintain capital against the full amount of such loans sold. As such, even the retention of the subordinated portion of a senior/subordinated loan participation will be treated in the same manner as other asset sales with recourse. The provision is a response to potential abuse of the exception under existing rules for recourse of 10 percent or less of the loan package. We maintain that this provision will tend to oblige institutions to reserve, in effect, up to 500 percent of the amount of the portion retained.

Rather than the effective 500-percent risk-weighting that will result where an asset is required to be fully capitalized against, we suggest a more modest, 200-percent weighting. Moreover, the risk-weighting should be tied into the risk on the underlying loans. Whether the 200-percent weighting applies should depend on the character of the split, and the loan-to-value ratio of the underlying loans.

The National Council also notes that, as written, this provision will substantially modify the current "with recourse" rule followed by institutions trading on the secondary market. The provision will effectively impose a capital requirement on all mortgage-backed securities sales in which a subordinated interest has been retained, without regard to whether the institution retains a 10-percent (or less) interest in the mortgage pool. We believe that this peculiarity will significantly affect the secondary market in home loans, resulting in higher interest costs to consumers, without any reduction in risk to FSLIC. The FDIC's Call Report rules do not require national banks to hold capital against loans sold where less than 10 percent of the loan has been retained. Given the way the Bank Board's provision reads, therefore, only commercial banks will be able to issue securities that have a AA rating from Moody's and Standard & Poors.

The Bank Board also proposes to convert interest-rate contracts to credit equivalents. Interest-rate contracts are defined broadly to include interest-rate swaps, futures, over-the-counter options, interest-rate options purchased, and forward-rate agreements. The instruments will be converted by utilizing the so-called current exposure method. Under the current exposure method, the credit equivalent is deemed to be the total replacement cost of contracts at the end of the reporting quarter. The resulting credit exposure is then risk-weighted at 50 percent or lower, depending on the obligor.

The National Council believes that this provision, in its

present form, is too broad and does not account for economic and practical realities associated with many of these transactions. In many instances, the counter-party to a swap-type transaction will post collateral in the form of a bond, or alternatively is a counterpart of investment-grade quality. We believe that under these circumstances it is unreasonable to require the first party to the contract to reserve capital against the transaction; there is no risk to the institution or to FSLIC.

VII. Interest-Rate Risk

Another major component of the proposed risk-weighted capital requirement is the interest-rate risk basket. In proposing this requirement the Bank Board observed that thrift institutions have historically assumed significant interest-rate risk "because their asset portfolios have been heavily concentrated in long-term, fixed-rate residential home mortgages." To account for this maturity mismatch, the Bank Board proposes to use a discounted cash flow analysis to estimate the effect on an institution's value of an immediate and permanent 200-basis point movement in interest rates, whether up or down. Institutions will be required to maintain capital equal to 50 percent of the larger of the possible decreases in the market value of their net equity as a result to the 200-basis point increase or decrease.

The National Council recognizes the significance of interest-rate risk to thrift institutions, and shares the Bank Board's desire to find a solution that will more adequately hedge against the risks posed by volatile interest rates. The Bank Board, however, has not provided the public with a tangible proposal that contains specific provisions. Consequently, we are unable to approve a model that we have not seen, and that may not, in fact, adequately account for the realities of the situation facing the industry. We contend that such a rulemaking procedure is inappropriate. The National Council adamantly believes the contemplated interest-rate component must have its own separate comment period, and will fervently oppose any attempts to implement such a standard without an adequate period for public comment.

We do wish to suggest, however, that in drafting its model for proposal, the Bank Board should consider how it initially arrived at the 2-percent component, and whether it is the right amount. We believe that any model which is to serve as the component for interest-rate risk must remain static in up or down situations, since the prepayment assumptions cannot be changed once the model is implemented.

VIII. Phase-In

Finally, we note that the Bank Board proposes that all insured institutions are to be 80 percent in compliance with the new capital requirements by January 1, 1991, and 100 percent in

compliance by January 1, 1993. Moreover, we note that FIRREA currently contains a provision that will authorize the chairman of the FHLBB to require that all institutions meet certain capital requirements by June 1, 1991.

The National Council believes that it is impracticable for many institutions to comply with the Bank Board's implementation schedule as proposed. Earnings are under pressure from the special assessment and high rates payable on deposits caused partly by the FSLIC crisis itself. High premiums on deposit insurance are likely to continue, and costs on time deposits will continue to reflect the effects of the current crisis long after it has been resolved. Financings, such as preferred stock issued by finance subsidiaries and long-term advances used to reduce interest-rate risk, can be reversed only at a prohibitive cost.

The National Council recognizes, however, that the Bank Board has legitimate needs and statutory obligations to raise capital standards in the industry. It further recognizes that the Bank Board needs interim standards to assure steady progress toward increasing capital within the industry. Therefore, the National Council suggests that the Bank Board adopt a progressive phase-in schedule to be fully implemented by January 1, 1994.

Thank you very much for the opportunity to submit our comments on this most important issue. The National Council is sincerely eager to be an integral part of this rulemaking process. If you should have any further questions, or if the National Council staff may be of any service to you on this matter or on any other issue, please do not hesitate to contact us.

Sincerely,

Mark J. Riedy

Dr. Mark J. Riedy
President and
Chief Executive Officer

MJR:ded

Receipt of this letter (12 pages) is hereby acknowledged.

By: _____
Federal Home Loan Bank Board

Date: _____

RECEIVED

NATIONAL CONGRESS
FOR COMMUNITY
ECONOMIC DEVELOPMENT
1612 K Street, N.W., Suite 510, Washington, D.C. 20006 202/659-8411

1989
BOARD OF DIRECTORS

LEE BEAULAC
Chairperson
Rochester, NY

JOHN DEMPS
Vice Chairperson
Jacksonville, FL

STEPHEN McCONNELL
Treasurer
St. Johnsbury, VT

DONALD COMSTOCK
Secretary
Seattle, WA

GEORGE L. TWEFTY
Past Chairperson
Lafayette, LA

PETE GARCIA
At Large
Phoenix, AZ

MARY NELSON
At Large
Chicago, IL

LEONARD REED
At Large
St. Thomas, VI

DAPHNE SLOAN
At Large
Cincinnati, OH

WILLIAM HINEBAUGH
State CED Association
Representative
Indianapolis, IN

JOHN E. TAYLOR
State CED Association
Representative
Somerville, MA

LEASA DAVIS
NE Co-Vice Chairperson
Fortress, MA

WILLIAM JONES
NE Co-Vice Chairperson
Dorchester, MA

RONALD PHILLIPS
NE Co-Vice Chairperson
Worcester, NE

TERRY CONWARD
Southern Co-Vice Chairperson
Miami, FL

R. L. RAMSEY
Southern Co-Vice Chairperson
Chattanooga, TN

NATHANIEL WHITE
Southern Co-Vice Chairperson
Durham, NC

MARIANNE GORCZYCA
MW Co-Vice Chairperson
Dayton, OH

JAMES KING
MW Co-Vice Chairperson
Cincinnati, OH

RICHARD SCRUMM
MW Co-Vice Chairperson
Fond du Lac, WI

DEBORAH CALL
Western Co-Vice Chairperson
Anchorage, AK

RODNEY FERNANDEZ
Western Co-Vice Chairperson
Salinas, CA

JAMES RAISCH
Western Co-Vice Chairperson
Portland, OR

ROBERT O. ZDENEK, CAE
President
Washington, DC

STATEMENT

Submitted By

NATIONAL CONGRESS FOR COMMUNITY ECONOMIC DEVELOPMENT

ON
S. 565
A BILL TO AUTHORIZE A NEW CORPORATION TO SUPPORT STATE AND LOCAL STRATEGIES FOR ACHIEVING MORE AFFORDABLE HOUSING; TO INCREASE HOMEOWNERSHIP; AND FOR OTHER PURPOSES

TO THE
SENATE HOUSING SUBCOMMITTEE

THE HONORABLE ALAN CRANSTON AND ALFONSE D'AMATO

JUNE 9, 1989

Senators Cranston and D'Amato, we would like to thank you for the opportunity to present this statement of the views of the NATIONAL CONGRESS FOR COMMUNITY ECONOMIC DEVELOPMENT (NCCED) on the Homeownership section of S. 565--the "National Affordable Housing Act".

We would like to begin by saying a few words about NCCED, and then move on to a discussion of non-profit community development corporations, more commonly known as CDCs, and their role in the production and provision of homeownership opportunities for low and moderate-income persons throughout the country, and the importance of the "National Affordable Housing Act" to these efforts.

NCCED is a national, not-for-profit membership association of over 200 community-based development organizations engaged in the economic revitalization of distressed communities. Founded in 1970, NCCED is committed to increasing the financial and technical resources available for community economic development--not the least of which is affordable housing. The association is governed by a 22-member Board of Directors elected by the membership. Board members represent both rural and urban areas from across the country.

NCCED members include community development corporations (CDCs), neighborhood housing groups and community action agencies as well as corporations and not-for-profit intermediaries providing financial and technical support for community development. Member organizations are engaged in a variety of

activities, including housing construction and rehabilitation, real estate development, industrial and small business development and employment generation.

NCCED serves as a central source through which organizations involved in community economic development activities can share information, exchange experiences, compare strategies and gain technical information and knowledge. In this capacity, NCCED regularly sponsors conferences and technical training sessions and undertakes research and policy studies. The association also publishes and produces numerous books, periodicals and audio and video cassettes related to community economic development issues.

In addition, NCCED serves as an advocate for community development organizations, working with federal, state and local policy leaders in both the public and private sectors to increase their support of community development activities.

As stated above, CDCs are committed to the revitalization of their neighborhoods. The revitalization of neighborhoods assumes a previous vitality and an investment of resources, public and private. It further assumes a decline in that vitality and, a corresponding disinvestment of resources. "Revitalization" states an intention to live again where life once flourished.

In this context, the self-interest of individuals can best be harnessed for neighborhood benefit through home ownership. Long-term neighborhood stability and self-maintaining investment will result by fostering practical and attractive home ownership

opportunities and by conspicuously aggregating those opportunities.

Those opportunities, along with the overall aggregate production of affordable housing by non-profit housing developers has just recently been measured by a national survey conducted by NCCED. The report of the survey, "Against All Odds: The Achievements of Community-Based Development Organizations", reveals that about one-half of the estimated 1,500 to 2,000 CDCs throughout the country have built 125,000 units of housing--over 90% for low-income occupants. Several of these non-profit housing developers have created home ownership and home ownership counseling programs for their low-income constituents. These CDCs, therefore have a keen interest in the Home Ownership section of this bill.

The HOP program can be of assistance to their efforts. We applaud the inclusion of the 10% set-aside for non-profit community organizations. It is clear that substantial subsidies will be needed on the state and local levels to bridge the gap between the costs of a low-income housing project and the rents and sale prices that can be supported in economically distressed neighborhoods.

Although no realistic level of new federal funding will be nearly sufficient to meet low-income housing needs, it would be unfortunate if new federal funding were to replace the modest level of state and local support, instead of encouraging additional commitments.

In the area of home ownership programs set up by CDCs which was alluded to earlier, these programs run the gamut from lease/purchase to "sweat equity". One thing they all have in common is a home ownership counseling component. To answer the question of Subcommittee staff, "how should housing counseling be structured?", one need look no further than the successful home ownership counseling programs that these CDCs have developed. NCCED would be more than willing to assist the Subcommittee in formulating this structure. NCCED has several members who are presently operating their own home ownership and home ownership counseling programs.

In conclusion, over the past 10 years, low-income housing problems have worsened in many markets, and a new wave of local initiatives has sprung up to address these problems with little federal support.

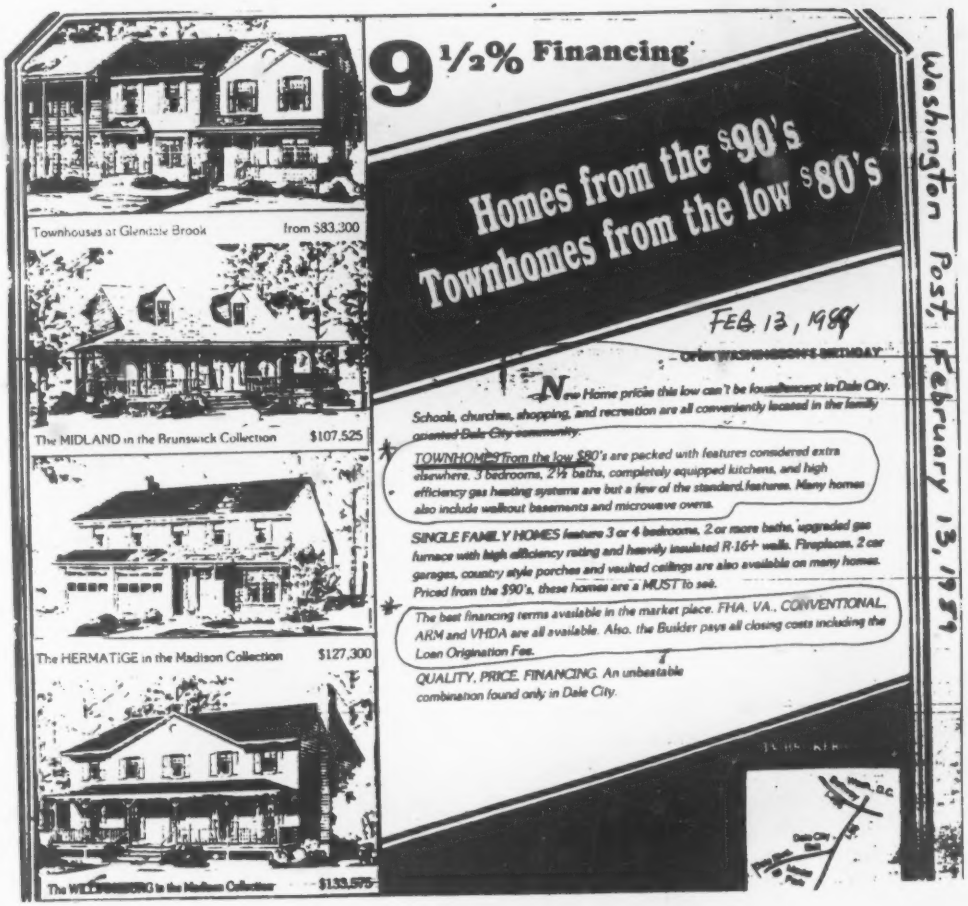
Clearly, low-income housing is a national issue that requires a national commitment. From budgetary, political, and programmatic perspectives, it is neither likely nor appropiate for the federal government to bear the entire responsibility for funding and carrying out new housing programs.

But over the last decade, a broad range of other institutions--states and localities, CDCs and profit-motivated developers, lenders, non-profit intermediaries, and foundations--have joined together to form creative and productive partnerships.

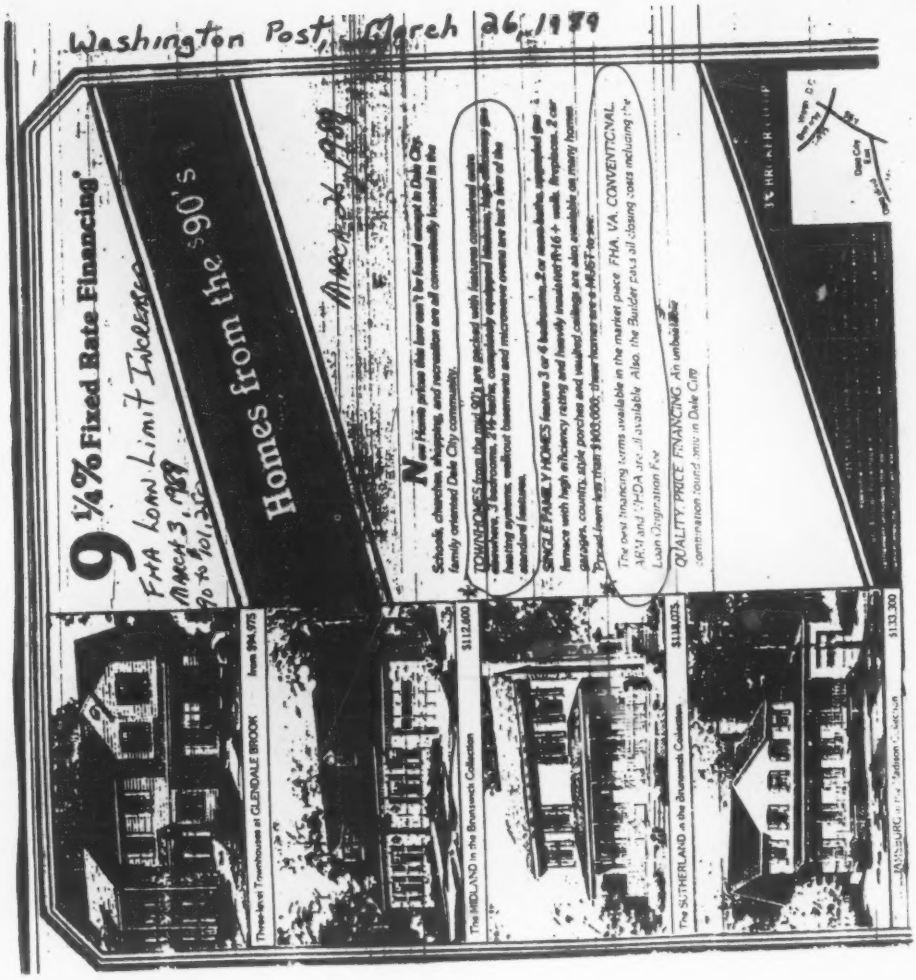
These local initiatives are the basis for a new housing

production system that is more effective, efficient, and responsive to local needs than previous federally driven efforts; but their growth will be stunted without the level of public subsidy that only the federal government can provide.

Toward these ends, we support S. 565, and are willing and available to assist the Subcommittee in perfecting its structure.


9 1/2% Financing
Homes from the $90's
Townhomes from the low $80's
FEB 13, 1989
Townhouses at Glendale Brook
from $83,300
The MIDLAND in the Brunswick Collection
$107,525
The HERMITAGE in the Madison Collection
$127,300
$139,575
New Home prices this low can't be found except in Dale City.
Schools, churches, shopping, and recreation are all conveniently located in the family oriented Dale City community.
TOWNHOMES from the low $80's are packed with features considered extra elsewhere. 3 bedrooms, 2½ baths, completely equipped kitchens, and high efficiency gas heating systems are but a few of the standard features. Many homes also include walkout basements and microwave ovens.
SINGLE FAMILY HOMES feature 3 or 4 bedrooms, 2 or more baths, upgraded gas furnace with high efficiency rating and heavily insulated R-16+ walls. Fireplaces, 2 car garages, country style porches and vaulted ceilings are also available on many homes. Priced from the $90's, these homes are a MUST to see.
The best financing terms available in the market place. FHA, VA, CONVENTIONAL, ARM and VHDA are all available. Also, the Builder pays all closing costs including the Loan Origination Fee.
QUALITY, PRICE, FINANCING. An unbeatable combination found only in Dale City.

Washington Post, March 26, 1989


9 1/4% Fixed Rate Financing*
FHA Loan Limit Increased
March 3, 1989
90's
Homes from the
New Homes priced this low won't be found except in Duke City.
Schools, churches, shopping, and recreation are all conveniently located in the family oriented Duke City community.
TOWNHOMES from the mid 90's are packed with features considered extra:
SINGLE FAMILY HOMES feature 3 or 4 bedrooms, 2 or more baths, separate gas furnace with high efficiency rating and heavily insulated R-16+ walls. Fireplaces, 2 car garages, covered patios, side porches and vaulted ceilings are also available on many homes.
Priced from less than $100,000, these homes are a MUST to see.
The new financing terms available on the market place FHA, VA, CONVENTIONAL, ARM and GPM are all available. Also, the Builder pays all closing costs including the Loan Origination Fee.
QUALITY PRICE FINANCING. An unbeatable combination found only in Duke City
Three-br. Townhouses at GLENDALE BROOK from $94,975
The MIDLAND in the Brunswick Collection $112,600
The SUTHERLAND in the Brunswick Collection $118,075
$113,300